The Economist

The state of the race
PAGE 25
Afghanistan votes
PAGES 34 AND 37
Reinventing McDonald's
PAGES 63-65
SURVEY OF IRELAND
AFTER PAGE 50

OCTOBER 16TH-22ND 2004 www.economist.com

Beating cancer

The new frontier of molecular medicine

US$4.95 • C$6.95

ONLINE FEATURES

Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

PRINT EDITION

Full contents
Enlarge current cover
Past issues/regional covers

GLOBAL AGENDA

POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

The Economist Group
Economist Intelligence Unit
Economist Conferences
The World In
Intelligent Life
CFO
Roll Call
European Voice
EuroFinance Conferences
Economist Diaries and Business Gifts

Advertisement

Print Edition October 16th 2004

Beating cancer
The war on cancer is entering a new phase ... More on this week's lead article

The world this week

Politics this week
Business this week

Leaders

Molecular medicine
Beating cancer

Afghanistan's election
Dreams and promises

Australia
Breaking the curse

The Irish economy
A model of success

Emerging economies
Grow up

British society
Proles apart

Kenya's Nobel laureate
The woman who planted trees

Letters

On pensions, Catalan, Kookmin Bank, Pakistan, the European Union, heat

Special Report

Australia's election
A prime minister with nine lives

United States

After the debates
Down to the wire

Getting out the black vote
Don't blush, just flush

The corporate tax cut
Lobbyists' delight

The electoral week
On the trail

The nastiest race in Texas
Stripped for action

South Carolina's Senate race
Big ideas and bigotry

Getting out the vote
Bush people

Lexington
Last chance for the Democrats?

The Americas

Life in Cuba
Small business just got smaller

Bolivian politics
Goni gone, but not forgotten

Guatemala's civil-war victims
Holistic healing

Canadian hockey
On ice

Asia

Afghanistan's election
Taliban? What Taliban?

Japan
The taxman cometh

Taiwan and China
Speaking across the strait

Sri Lanka's peace process
As good as it gets?

Previous print editions
Oct 9th 2004
Oct 2nd 2004
Sep 25th 2004
Sep 18th 2004
Sep 11th 2004
More print editions and covers »

Subscribe
Subscribe to the print edition
Or buy a Web subscription for full access online
RSS feeds
Receive this page by RSS feed

A survey of Ireland

The luck of the Irish
Tiger, tiger, burning bright
Measure for measure
Why worry?
Civil-war politics
Horses for courses
In place of strife
A European country like any other
Acknowledgments
Offer to readers

Business

Chief executives
Passing the baton

Retailing
On Target

Craigslist
Honouring nerd values

Textiles
Losing their shirts

Steel
Samba school

Face value
The way of the Warrior

Special Report

McDonald's turned around
Big Mac's makeover

Finance & Economics

Emerging economies
Coming into flower

Parmalat
The gloves come off

Money-laundering
Coming clean

Central European stock exchanges
Allied or alone?

Bond markets
Ripe

Banking in Germany
Not so bleak

Cross-border acquisitions
Very odd

Economics focus
Cycles and commitment

Correction: Czech interest rates

Science & Technology

The future of cancer treatment
Up close, and personal

Books & Arts

Asia, Europe and Myanmar
Face-off

North Korea
To Pyongyang with love

Middle East & Africa

Egypt and Israel
Bonded by bloodshed?

Iraq
A chink amid the gloom

Cameroon
Come back in six months

Malaria
Biting back

South Africa
Grumbles about the new tycoons

Liberia
Presidential striker?

Robert Guest

Europe

Italian government
Silvio Berlusconi's constitutional exercise

Lithuanian elections
The voters strike back

Belarus
Luka the bad

Germany's opposition
Doing their best to lose?

Macedonia
On the edge

Kosovo
Status quo?

Charlemagne
The let's pretend parliament

Correction: Dutch GDP

Britain

Pensions
Harsh choices

Guns in Nottingham
Disorganised crime

Contemporary art
Philistines flabbergasted

Drug treatment
Coming clean

Education
Snooty or what?

Computerising the NHS
Déjà vu all over again?

Stock exchanges
Crowding out

Bagehot
Mr Blair goes big

Articles flagged with this icon are printed only in the British edition of *The Economist*

Islam and the West
The new with the old

Religious tolerance
A big tent

Europe's early encounters with Asia
East meets West

National Geographic Society
Kith and kin

New fiction
South African badlands

Idling
A call to inaction

Obituary

Obituary
Christopher Reeve

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Portfolio poll

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Official reserves

Emerging-Market Indicators

Overview

Growth competitiveness

Economy

Financial markets

Advertisement

Classifieds

Jobs
Managing Director
This is a senior management position with direct responsibility for ongoing asset management acti....

Business / Consumer
WSI Internet - Start Your Own Business
Business Opportunity - WSI Internet Start Your Own Busines....

Tenders
Republic of Ghana Ministry of Trade, Industry, PSD & PSI - Request for Expression of Interest: Preparation of Competition Bill for Ghana

Jobs
Senior Manager & Francophone Translator/Proof Reader
VACANCIES AT THE AFRICAN PEER REVIEW MECHANISM (APRM)

Business / Consumer
English Bulldog For Adoption
Top quality English Bulldog puppies available! The bullies are Champion....

Tenders
Republic of Ghana Ministry of Trade, Industry, PSD & PSI - Request for Expression of Interest: Feasibility study for the Establishment of a Free Port

Sponsors' feature About sponsorship »

Copyright © The Economist Newspaper Limited 2006. All rights reserved. Advertising Info | Legal disclaimer | Accessibility | Privacy policy | Terms & Conditions | Help

Produced by =ECO PDF TEAM=
Thanks xxmama

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Politics this week

Oct 14th 2004
From The Economist print edition

Mostly armless

AFP

Under an agreement with **Iraq's** interim government, militias loyal to a rebellious Shia cleric, Muqtada al-Sadr, in the north-east slumland of Baghdad began to hand in their arms to the Iraqi police. Despite efforts by the government to start negotiations both with the Sadrists and with leaders of Iraq's disaffected Sunni Muslims, the insurgency showed no sign of abating. Kenneth Bigley, a British engineer who had been held captive for three weeks, was beheaded.

See article

Iraq's government urged would-be donors at a conference in Tokyo on rebuilding the country to forgive its debts, estimated at as much as $125 billion.

At least 34 people, including at least 12 Israelis, were killed by two suicide bombs that went off at a hotel and resort in Egypt, near the main Sinai border crossing with **Israel**, on the Gulf of Aqaba. A group linked to al-Qaeda, or with similar aims, is suspected of carrying out the attacks. The event may strengthen Egyptian and Israeli co-operation, including over Palestine.

See article

Israel's efforts to squash Palestinian militants in the **Gaza** strip in the run-up to its proposed departure continued. At least 96 Palestinians, many of them civilians, have been killed since September 29th, for the loss of three Israelis. Ariel Sharon, Israel's prime minister, mindful of a crucial Gaza-withdrawal debate due on October 25th, renewed his attempt to shore up his coalition government, after parliament rejected his opening speech of the new session by 53 votes to 44.

A Kenyan environmental and human-rights campaigner, **Wangari Maathai**, became the first African woman to win the Nobel peace prize. She reiterated a claim that AIDS is the result of a biological agent designed to wipe out black people.

See article

Sinned against

A **European Parliament** committee voted against the nomination of Italy's Rocco Buttiglione as European commissioner for justice and home affairs after he said that homosexuality was a sin. But he may still get the nod, as the parliament has no power to reject individual commissioners, and the commission's president-designate, José Maria Barroso, strongly backed him.

See article

EU foreign ministers unanimously agreed to lift the **arms embargo** on Libya. But the embargo on China will stay, even though some member governments—particularly France—want it to go too.

Lithuania's voters deserted the governing parties in the first round elections to give strong support to a new populist Labour Party, led by Viktor Uspaskich, a businessman with Russian connections. But it is not certain that Labour will join a new government.

See article

Closing statements

AFP

George Bush and John Kerry concluded their series of **televised debates** with a discussion on domestic policy broadcast from Tempe, Arizona. As with the previous meeting held in St Louis, Missouri, it was a lively exchange. Mr Kerry seems to have gained most from the debates by reducing Mr Bush's small lead in the polls.

See article

Yaser Esam Hamdi, an American citizen captured during the war in Afghanistan in 2001 and held without charge as an "**enemy combatant**", was freed and returned to his home in Saudi Arabia. In June, the Supreme Court ruled that Mr Hamdi could challenge his detention in court, a decision that allowed his lawyers to negotiate his release.

The Democrats complained about a plan to air a documentary attacking Mr Kerry's **anti-war activities** in the early 1970s. Sinclair Broadcast Group wants to show the programme on its 62 television affiliates, which, the Democrats argue, breaks political-broadcasting rules.

See article

Scientists reported that an observatory in Hawaii had recorded unusually strong increases in the level of atmospheric carbon dioxide, the main **greenhouse gas**, in 2002 and 2003. Although greens worried that global warming might be happening faster than previously thought, such a conclusion is premature. Two years do not make a reliable trend, and CO_2 levels rose only in certain parts of the globe.

Howard's way

Australia's prime minister, John Howard, won a fourth general election victory. He also looked set to take control of the Senate, something no Australian government has done for more than 20 years.

See article

Afghanistan's presidential election was more peaceful than anyone had dared hope. The results will not be known for at least two weeks, but the incumbent, Hamid Karzai, looks set to trounce his 17 opponents. A row over voting fraud, which saw all his rivals threatening to boycott the election, seemed to have been resolved. But an American proposal to give NATO control of all foreign troops in Afghanistan was opposed by France and Germany.

See article

The Indian state of **Maharashtra**, the country's second biggest, went to the polls. The result will be viewed as a first assessment of the record of the new Congress government in Delhi.

Chen Shui-bian, the president of **Taiwan**, called for direct talks with China. These were rejected by the mainland, which warned that his "separatist plans" risked a "great catastrophe".

See article

School's out of pocket

Mexico's Congress cut federal education subsidies for Mexico City by $350m (says the government) or $800m (says the mayor, who claims it is all part of a plot to undermine his presidential ambitions).

Supporters of **Venezuela's** president, Hugo Chávez, pulled down Caracas's

Reuters

statue of Christopher Columbus to celebrate the anniversary of his landing in the Americas. Mr Chávez has renamed it “Indian Resistance Day”.

Costa Rican prosecutors were standing by to arrest the head of the Organisation of American States, Miguel Ángel Rodríguez, as soon as his term—and immunity from prosecution—officially expired on October 15th. He agreed to resign, just two weeks after starting the job, over charges that he took a bribe while president of Costa Rica.

Canada's ice hockey season began without a single puck being hit in the National Hockey League. A stoppage over a pay dispute threatens to last all season, if not longer.

See article

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Business this week

Oct 14th 2004
From The Economist print edition

Volkswagen in the dock

The European Commission announced that it would take the German government to court for refusing to get rid of a law giving **Volkswagen's** home state of Lower Saxony a “golden share” that allows it to control decisions by the carmaker's board. Germany regards the law as a vital bulwark against the loss of jobs to eastern Europe. The commission contends that it deters potential foreign bidders for the firm.

See article

General Motors said that it will cut some 12,000 jobs at its loss-making European operations over the next two years, nearly 20% of the workforce in the region. The cuts will be made mainly at the company's German factories. Despite the bad news, the world's biggest carmaker reported slightly stronger profits of $440m in the third quarter. However, this was at the low end of expectations.

Russia's government announced that it would sell parts of Yuganskneftegaz, **Yukos's** largest production subsidiary, to meet the oil giant's burgeoning tax bill. Earlier, a court rejected Yukos's appeal against part of a bill of $4.1 billion for 2001. The government claims that Yukos is also dragging its heels over paying a $3.4 billion bill for 2000. The assets could go cheaply to government cronies.

Ahold and three former executives of the Dutch food firm agreed to settle charges with America's Securities and Exchange Commission related to the overstatement of profits by some $1 billion at an American business unit. Ahold escaped a fine because it had co-operated fully and taken extensive action to ensure it wouldn't happen again.

Germany's government took advantage of a recent surge in the share price of **Deutsche Telekom** and sold a 7% stake, held by a state-owned development bank, for some *euro*4.5 billion ($5.5 billion). The government said that it hopes to sell its remaining 36% of the telecoms giant by 2006.

American regulators agreed to delay by six months the implementation of rules that require the compulsory expensing in company accounts of **stock options** awarded to employees. Many big technology firms, which have resisted the new standards, may use the time to try to block the rules or change the methods of valuation.

Shop ‘til you drop

Carrefour, the world's second-largest retailer, gave warning that profits for the year would fall short of forecasts. The French firm blamed strong competition at home and the weak dollar for its travails. Its shares have fallen by 19% this year. It promised to raise *euro*1 billion ($1.2 billion) by selling underperforming overseas assets.

J. Sainsbury looked like losing more ground to Asda and Tesco after the embattled British supermarket chain issued a third profits warning this year. The company will shortly issue a plan aimed at reviving its fortunes.

Chips with everything

Apple Computer's profits more than doubled in the latest quarter compared with a year ago, to $106m. Sales of the technology firm's iPod music player boomed—2m were sold in the period and its success has

attracted buyers to other Apple products.

Philips Electronics reported that it made *euro*1.2 billion ($1.5 billion) in the latest three months, its biggest quarterly profit for some years. But the Dutch firm, which is also one of Europe's leading chipmakers, added that the outlook was less rosy because chip sales would remain flat and an oversupply of flat-panel TVs would drive prices down.

Profits at **Intel** rose by a healthy 15% in the latest quarter compared with a year ago. Intel made $1.9 billion and said that bulging inventories, run up in expectation of a boost in demand, had begun to shrink. But it cautioned that chip sales would stay weak.

The European Commission expanded an inquiry into government **procurement of chips** in the EU. It asked France, the Netherlands, Finland and Sweden to provide information on public computer tenders that have required Intel chips rather than those from its rival, **AMD**, in violation of competition rules. Italy and Germany are already under investigation.

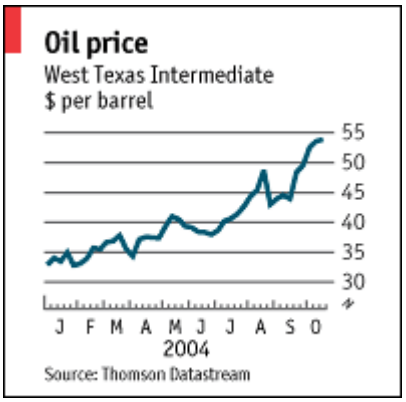
Yahoo! Whoopee!

Strong online advertising revenues more than tripled quarterly profits at **Yahoo!** over a year earlier to $253m. This includes cash from the sale by the world's number-two search engine of a stake in the market leader, Google, which reveals its first results as a public company later this month.

DreamWorks, the film company responsible for “Shrek” and a host of other popular animated feature films, said that it planned an initial public offering. The Hollywood studio will sell a 27% stake in a deal that could value it at up to $2.6 billion.

Up again

The price of **oil** rose above $54 a barrel as forecasts of future demand exceeded previous estimates and threats to supplies persisted. Meanwhile, copper crashed from near 16-year highs, falling 11% in one day, as investors cashed in on sky-high prices. Other metals, including aluminium and zinc, also suffered steep falls.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

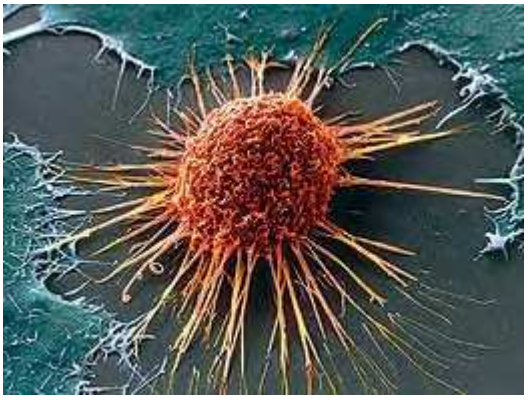
About sponsorship

Molecular medicine

Beating cancer

Oct 14th 2004
From The Economist print edition

The war on cancer is entering a new phase



"CANCER" is one of those words that sends shivers down the spine. The phrase "battle with cancer" is a headline writer's cliché. And the military metaphor was widened in 1971, when Richard Nixon—then president of the United States—announced an initiative that later became known as the "war on cancer". Cancer, however, has not been beaten. Indeed, by some measures the problem is worse than it was three decades ago. It is true that treatments have improved somewhat, and prognoses with them, and that a few forms of the disease, particularly in children, can be cleared up altogether. But the biggest success has been due to people giving up smoking, rather than to new treatments. And despite that success, the likelihood that a person will get cancer at some point in his life has actually risen since Nixon's speech.

If the past three decades of effort have seemed a disappointment, the next decade could prove to be one of rapid progress. The battle against cancer is at a turning-point. Because of recent advances, it is becoming possible to imagine a time in the not-too-distant future when new medical treatments will be able to tame the disease, transforming it from a potent killer into something akin to a chronic complaint. The day when cancer no longer strikes terror in the heart of those diagnosed with it may not be far away (see article).

Researchers have unravelled much of the basic molecular biology of cancer and, aided by the outpouring of knowledge that the Human Genome Project has yielded over the past ten years, they have come to understand how the disease progresses. Indeed, they have come to understand far more clearly than before that the term "cancer" properly refers not to a single disease, but rather to a whole range of diseases that have in common only the fact that they are caused by cells that do not know when to stop dividing. That understanding has now reached the point where it can be turned into action. The next few years should see an array of new treatments that will add up to a big change in the way that cancer is viewed and dealt with by society.

This is obviously good news. It does not stop there. This new approach may very well herald a more general change in the way that many diseases are treated. For much of what distinguishes the new cancer treatments from the old is the precision with which they are aimed at the disease they are intended to treat. The same kind of genetically based precision should be possible in treating other diseases as well, with equally beneficial results.

No gain without pain

However, achieving the great promise of this new approach will not be easy. Doctors will have to change the way they diagnose and treat many diseases. Even more wrenching will be the changes needed in how the drug industry operates.

At the moment, most drug firms concentrate on so-called "blockbuster" drugs, one-size-fits-all treatments for common conditions. These sell in huge quantities and are wonderful for profits. But in fact many such drugs work on only some of the patients they are given to, even though all those patients appear to have the same symptoms. Worse, some patients suffer serious side effects while others have

few, or none. In the worst cases, this can lead to the withdrawal of a drug that clearly works, in order to protect that minority. Worries of this kind about Vioxx, a pain-reliever given to people with arthritis, caused Merck, its manufacturer, to withdraw it from sale two weeks ago.

The new approach will change this—paradoxically, by multiplying the number of diseases. In the case of cancer, tumours that look identical under the microscope are turning out to be very diverse when examined at the molecular and genetic levels. Often, this means they require completely different treatments, which explains why existing therapies work only for a proportion of those afflicted. The hope is that this knowledge will lead to the development of treatments for these individual “molecular-level” diseases, which will mean both that more people can be treated successfully, and that treatment can be confined to those individuals for whom it will actually work. Similarly, molecular and genetic knowledge will reveal who is most likely to suffer side effects, and that information will be reflected in which treatments are prescribed.

Molecular dilemmas

From the patient's point of view this move to personalised medicine should bring huge benefits. But today's drug industry is ill-equipped to deliver them. One obvious temptation for drug firms will be simply to focus on treatments for the most common molecular subtypes of a disease, ignoring rarer subtypes and even excluding people with these from clinical trials, and thus from being prescribed the drugs themselves.

Another risk is that the new drugs will be significantly more expensive than the old. Although, in the long run, they should be cheaper to develop—because companies will be able to hand-pick participants with the right genetic subtypes for their clinical trials, and thus conduct those trials more efficiently and cheaply—most drugs also will have smaller markets than their predecessors, and so initially may have to be priced higher.

Whether those footing the bill in the rich world—ultimately, taxpayers and patients—will accept this argument, and pay more for individual treatments, is uncertain. And this still leaves the problem of patients in poorer parts of the world. Countries wealthy enough to see their populations survive infectious diseases, such as malaria, and go on to develop cancer and other diseases of affluence, are not necessarily rich enough to afford new and improved drugs.

These difficulties are real, but they are not insurmountable. They should be viewed as challenges to be faced rather than as excuses not to exploit what is the most promising avenue for medical progress in years. If personalised molecular treatments are, as now looks likely, able to score their first victory against that scary old enemy, cancer, there will be little doubt about their immense potential in other areas.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Afghanistan's election

Dreams and promises

Oct 14th 2004
From The Economist print edition

Afghans have voted to heal their broken country; they will need help

AP

THE Taliban, one can assume, were not amused. On October 9th, Afghans took part in an election shot through with technical flaws and voter manipulation, but not bullets. Three policemen were killed while guarding ballot boxes in southern Uruzgan province, in addition to 14 election workers murdered during the year. But this was nothing like the Armageddon promised by remnants of the former regime.

If the Taliban threat was a damp squib, the election also exposed one or two other myths. First, despite its flaws, the poll showed that democracy is possible in even as broken a country as Afghanistan. Many Afghans voted for the candidate of someone else's choice, taking instruction from a husband, a tribal leader or a local strongman. Yet the election was better characterised by the eagerness of millions of poor Afghans to cast their ballots, and their delight when they did so. In a moment of jeopardy, when every opponent of Hamid Karzai, Afghanistan's transitional leader, withdrew from the contest in protest at a technical glitch, Afghans rescued the day. Mr Karzai's rivals were persuaded to end their boycott not merely at the bidding of the country's donors—though that bidding was forceful—but also after hearing their countrymen voice contempt for their actions on radio phone-ins across the country.

Another myth concerned the supposedly terminally divided nature of Afghan society. According to an exit poll, Mr Karzai should win an outright majority of votes. This is less because of what he has done for Afghans than what Afghans want him to do. Three years since the Taliban's demise, many are barely touched by the central government, and are exposed instead to factional violence, druglords and bandits. Mr Karzai, a mild-mannered conciliator, who belongs to Afghanistan's biggest tribe, the Pushtuns, but wears the costumes of Uzbeks and Tajiks, represents something better to Afghans: a dream of national unity.

Backed by America and its allies, Mr Karzai also represents a foreign rescue effort that has often been patchy. It started with trepidation, when America avoided deploying ground troops to topple the Taliban, and thereby created a vacuum in which warlords could thrive. And trepidatiously it has continued: last year, America's NATO allies promised to send peacekeepers into the unruly provinces, but they have barely delivered. In general, donor nations have seemed terrified of Afghans' reputation for spurning foreign aid and devouring foreign armies. But this too was mostly myth. Afghans, as Mr Karzai's victory will prove, want more foreign help, not less.

Mr Karzai and his sponsors should listen to them. Enriched by drug money, and emboldened by NATO's timidity, the warlords are growing stronger, inside and outside government. Mr Karzai, assuming he wins

the election, must confront them. The new cabinet should include no men with private militias. The militias must then be disarmed. For this task, Mr Karzai will require more than a majority of votes. He will need NATO to deploy the troops it has promised; America, with its superior might, to back them; and the UN to gather in the guns.

Failing these steps, Afghanistan will not become prosperous and whole, and the memory of its surprisingly blessed election will soon fade. But future historians will know the reason why. It will not be because of the wild terrain that trapped Soviet tanks, or the abandon with which Afghan tribesmen once butchered British troops. It will be because the world's richest countries failed to keep their promises.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Australia

Breaking the curse

Oct 14th 2004
From The Economist print edition

In John Howard's fourth win, a booming economy trumps an unpopular war

Get article background

AFP

IN THE mid-1990s, Saddam Hussein could gloat that those who had sought to defeat him after he had invaded Kuwait—Margaret Thatcher, George Bush senior and even, albeit through acquiescence only, Mikhail Gorbachev—were the ones that ended up out of a job. After the second Iraq war, there was reason to believe that the Curse of Saddam was operating again. Spain's Popular Party, an enthusiastic backer of the war, was booted out of office in March. Tony Blair's popularity has plummeted. George Bush junior faces a stiff challenge from John Kerry. And, in Australia, a couple of months ago, John Howard's long hold on power looked about to be broken by a 43-year-old near-unknown, the Labor Party's Mark Latham.

Instead, Mr Howard has won a truly impressive victory: a fourth three-year term, an achievement bettered only by Sir Robert Menzies between 1949 and 1966; and control or effective control of Australia's Senate, something no Australian government has enjoyed since 1981. He has done this despite heated popular opposition to Australia's participation in the Iraq war, the largest demonstrations in the country's history, and a promise by his opponent to bring the remaining troops home by Christmas. How come?

There are several parts to the answer, but one is that the issue of Iraq is evidently becoming less toxic with time. An Iraqi government—interim and far from satisfactory though it is—is calling at least some of the shots. Though gloomy, even atrocious, news is still regularly heard from the so-called “Sunni triangle” in the centre of the country, in the Shia south and the Kurdish north you would not find many who regret Saddam's ouster. And it is possible that some of those who so angrily demonstrated against the war are feeling a little queasy at now finding themselves on the same side of that argument as the sort of people who take aid-workers hostage and decapitate some of their victims on video.

This last point may carry particular clout in Australia, which lost so many young people in the 2002 Bali bombing. Helpfully for Mr Howard, Islamic terrorists reminded voters of this by setting off a bomb outside the Australian embassy in Jakarta a month before the election, killing nine Muslims though no Australians. So it may turn out that the Spanish Popular Party's is the only scalp that the war in Iraq claims—and that one had as much to do with the government's attempt to blame the Basque separatist group ETA for bombing Madrid just before the election as with Spain's participation in the war itself.

It was the economy, stupid

If Iraq was not an election-maker or breaker in Australia, there are no prizes for guessing what was. Mr Latham was attempting to oust Mr Howard at a time when Australia had entered its 13th consecutive year of economic growth, the longest sustained period of expansion in its history. Its budget is in surplus, its public debt, at 18%, is the lowest in the developed world. Unemployment is close to a 20-year low of 5.6%. All this allowed Mr Howard to make some lavish campaign promises, mainly to do with medical care and other benefits for pensioners. These were thrusts deep into Latham territory, although there are doubts about whether Mr Howard will be able to afford them, especially if the economy weakens.

And weaken it might. There are still many things, including a property crash, or softer demand from commodity-hungry China, to worry about (see article). But even if the future is more uncertain, the voters seemed inclined to trust Mr Howard, who has presided over a decade of increasing prosperity, rather than the inexperienced Mr Latham. Now that he has control of the Senate, Mr Howard will probably be able to break Labor's block on the privatisation of the telecoms company Telstra, and attempt further deregulation of the labour market. But if he has to depend on the support of the tiny Family First party, the price might be moves towards a divisive, conservative social agenda. That could prove a mistake.

It is a useful rule of politics that electorates vote according to their pockets and kick out governments only when they have been given good reason to do so. Mr Howard was able to conjure up all sorts of demons—a task in which he was helped by the Labor party itself, with its public pledge to re-regulate the labour market, including by a re-introduction of national collective bargaining. That sort of thing scares middle-class voters, no matter how energetically Mr Latham struggled to soft-pedal his own party's policies. In the end, it was not much of a contest.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The Irish economy

A model of success

Oct 14th 2004
From The Economist print edition

What central Europe can learn from Ireland

THERE is something alluring about a model, especially one that works. If you find one, you can hope simply to copy it—and instantly enjoy similar success. That explains why all the eight countries of central Europe that joined the European Union in May, from Estonia to Slovenia, appear so fascinated by Ireland. They each hope that generous dollops of EU money, eased down with judiciously low corporate taxes, will mean that they can follow in the tracks of the "Celtic tiger"—and get rich quick.

There is no denying Ireland's success over the past 15 years. Between 1987 and 2003, its GDP per person rose from 69% of the EU-15 average to 136%. On this measure, Ireland is now the third-richest member of the club. Even when measured by GNP, which is usually more appropriate for Ireland because of its heavy dependence on foreign investment, it has caught up with the EU average. The country has become the prize exhibit for those who wish to advertise the huge benefits that flow from membership of the EU.

And yet, as our survey of Ireland argues, the roots of its economic success lie a lot deeper. For one thing, it was mainly a matter of catching up, after several decades of poor performance. Ireland largely missed out on Europe's post-war boom, and it also suffered after the oil shocks in the 1970s. By the late 1980s its economy had done so badly that it was poised for an economic spurt, with a young and growing population and plenty of scope to raise employment. All it took was a period of stable and sensible macroeconomic policies, something that Ireland had avoided for most of its history, to unleash its potential.

Money from the EU helped, of course. But it had flowed in ever since Ireland joined in 1973, usually to little effect. Even when they were at their peak in the early 1990s, transfers from Brussels were worth less than 5% of GDP. The best estimates are that EU cash may have raised annual growth in the 1990s by about half a point: helpful, certainly, but still modest when measured against average growth of 7%. Access to the European single market and Irish success in attracting foreign investment counted for more than EU budget transfers. But it was the country's favourable demographics, plus a sharp rise in female participation in the workforce, that were the biggest contributors to Ireland's boom of the 1990s.

Eastward, ho!

This is not to say that central European countries have nothing to learn from Ireland. But they should be careful to draw the right lessons. One that they have understood is the value of low corporate taxes in helping to attract foreign investment. The new EU members are right to resist the pressure now being piled on them by France and Germany to raise their corporate tax rates. But an even bigger lesson is the need to cultivate their workforce skills and knowledge base. For now, the biggest lure for investors in central Europe is not low corporate taxes but low labour costs, just as it was in Ireland in the late 1980s. But after 15 years of boom, Ireland has lost most of its low-cost advantage; it now relies on its years of investment in education and training to produce a higher-skilled workforce that still appeals to foreign investors. The central Europeans need to think ahead and follow suit.

Unfortunately, they cannot copy Ireland's favourable demographics, as most of the countries of central Europe are ageing even faster than those of greying western Europe. Nor do they have the same scope as Ireland had to draw more women into the workforce or to cut unemployment, though they could be doing a bit more of both. For these two reasons alone, the countries of central Europe are unlikely, even

if they get all else right, to match Ireland's dizzy growth of the 1990s.

The biggest lessons they should take from Ireland's experience apply in two areas they risk getting wrong: fiscal policy and labour-market flexibility. Since the late 1980s, Ireland has cut both its overall tax burden and its annual budget deficits; indeed, in most years it has repaid public debt, reducing its debt burden from one of the highest in western Europe to one of the lowest. If they are to act likewise, the central Europeans must be much tougher about cutting public spending, something that many governments in the region are finding politically tricky. And they also need to make their labour markets more flexible, instead of pursuing their current path of importing Europe's excessive regulation. For the central Europeans, in short, the road to prosperity is the same as it always was: freer markets, deregulation and smaller government.

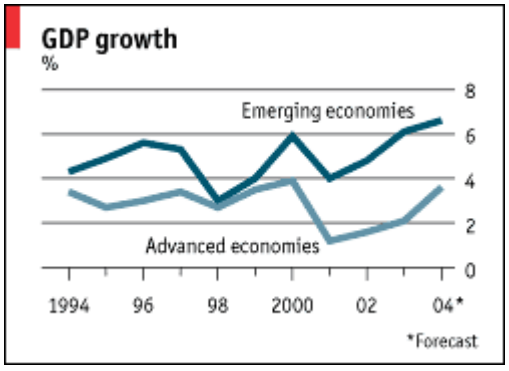
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Emerging economies

Grow up

Oct 14th 2004
From The Economist print edition

Developing countries are growing at their fastest pace for decades



RISING oil prices, ballooning budget deficits and other woes are understandably getting most of the attention of policymakers and economists. But perhaps it is time to shout about some economic cheer for a change: emerging-market and developing economies are, as a group, currently growing at their fastest pace for at least 30 years (see article). Three-fifths of the countries tracked weekly by *The Economist* are growing at a robust rate of around 6% or more, including the four biggest—China, India, Brazil and Russia. The IMF is forecasting that next year even sub-Saharan Africa could grow at its fastest in three decades. Faster growth will not automatically end poverty. That depends on how the fruits of growth are shared. But faster growth makes this goal more achievable.

To be honest, we hesitate to herald such facts. In 1994, when launching our emerging-market indicators page, we declared that this was to mark “a fundamental and remarkably rapid change in the balance of the world economy”. The emerging economies were then growing more than twice as fast as the rich and their stockmarkets were surging. Our timing was uncanny, but not in the way we intended: that same year emerging markets plunged. The following years saw a series of economic crises in Mexico, East Asia, Russia, Brazil and Argentina. Is today's rapid growth any more sustainable?

This time, some important trends have been a big help to emerging economies. Over the past year, America's consumer-spending binge and China's investment boom have both sucked in more imports from the developing world. Better still, strong global demand for raw materials, especially in China, has sharply pushed up the prices of metals and other commodities. Meanwhile, historically low American interest rates have lowered the debt-service costs of poor countries.

But emerging economies cannot rely on commodity prices rising, interest rates staying low or American consumers continuing to live beyond their means. Higher oil prices could yet trip up oil importers. And there is a clear risk that China's investment boom could turn to bust. Just like America during its emergence in the late 19th century, today's emerging economies tend to be prone to economic ups and downs resulting from external shocks or financial bubbles. But what matters most for their long-term growth prospects are their economic policies and their underlying financial health.

Fortunately, here too the picture is brighter than for years. Many, though far from all, countries have trimmed their budget deficits. Total government borrowing as a share of GDP in emerging economies is only half that in America. After years of persistent current-account deficits they are, as a group, now firmly in surplus and so less vulnerable to the whims of foreign investors. Since 1998 their total foreign debt has almost halved in relation to exports. Structural reforms, to curb government interference and allow markets to work better, have also improved the efficiency of investment.

Keeping on the fast track

It is imperative that poor countries not only continue to pursue such policies, but take advantage of their brisker growth to push ahead with further reforms. In theory, they should find it easy to grow faster than rich countries because they start with much less capital equipment per worker. That gives them huge scope for boosting productivity by importing machines and techniques from developed countries. But in

the past, poor government policy has often frittered away this natural opportunity for growth.

Governments that still have large budget deficits, notably in central and eastern Europe, need to wield the axe. Others in Asia need to use the extra tax revenues that growth provides to clean up their banking systems. Almost everywhere governments should do more to free up markets and reduce their own meddling. In Asia, that includes allowing greater exchange-rate flexibility. The refusal of China and other Asian countries to allow their exchange rates to rise is holding back the growth of domestic demand by subsidising exports. Yet stronger domestic demand would help to cushion these economies against future global shocks. Emerging economies are back on their feet, but still have a long way to go.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

British society

Proles apart

Oct 14th 2004
From The Economist print edition

Tony Blair bemoans the rigid British class system, but Labour is partly responsible for it

Corbis

FOR a man who announced triumphantly five years ago that the class war was over, Tony Blair seems to be doing his best to revive it. The bill to ban foxhunting has (at least in the eyes of the Labour left-wingers who promoted it) set the urban proletariat against the rural landlords. By bullying universities to discriminate against pupils from fee-paying schools, the government has infuriated well-off parents keen to do the best for their children. And, on October 11th, Mr Blair made it clear that he thinks he has underused Britain's old class chestnut as a political issue: raising social mobility to levels seen in the decades following the second world war would, he said, be a priority in his third term.

Mr Blair is right that social mobility has declined lately. According to an academic paper published recently, people born soon after the second world war were much more likely to move out of their parents' class than those born in later decades. But, though Mr Blair is happy to use the past as a rhetorical device, he does not seem to have learnt from it.

Social mobility took off after the second world war for two main reasons. First, the 1944 Education Act introduced free secondary education for all—for the bright at grammar schools and the less bright at secondary moderns. Grammar schools set clever working-class children on a fast track to social advancement; and the decline in the number of state-school entrants to Oxford and Cambridge can be directly related to the abolition of most of them in the 1960s and 1970s. Second, the university system expanded.

Mr Blair would argue that, by expanding the universities still further, he will get still more social mobility. But there are diminishing returns to tertiary education, particularly when so many people get such bad schooling. The real barrier to social mobility is now to be found in the secondary schools.

Labour's hostility to elitism has ensured that state schools remain non-selective. Private schools are increasingly academically competitive, so the quality gap between them and state schools is widening, and the government is trying to make up for its failure by fixing the university admissions system against those whose parents have the temerity to buy them a decent education.

There are things the government could do to encourage class mobility. Education vouchers, for instance, would allow poorer parents to give their children a leg up, but the Labour Party and the teaching unions are dead against them. Until the government adopts policies likely to make society less, rather than more, rigid, Mr Blair would do well to keep quiet about the iniquities of the British class system.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Kenya's Nobel laureate

The woman who planted trees

Oct 14th 2004
From The Economist print edition

Wangari Maathai is sound on reforestation; less so on AIDS

Reuters

THIS year's Nobel Peace Prize was awarded last week to Wangari Maathai, a Kenyan environmentalist-turned-politician, for planting 30m trees. Thanks to Ms Maathai, Kenya is a greener and more pleasant place than it would otherwise be. For this, she deserves our warmest congratulations. But what does planting trees have to do with peace?

A lot, say Ms Maathai's supporters. Conflict often springs from competition for water or fertile land. As deserts expand and populations soar, such competition can turn violent. The war in the Darfur region of western Sudan, for example, has its roots in the struggle between black farmers and Arab pastoralists over a slab of increasingly arid soil. By reforesting Kenya, Ms Maathai has made it less likely to go the way of Sudan. And the way she did it—by paying peasant women to plant seedlings in their own villages—empowers women, and so promotes peace even more.

This is a bit of a stretch. Ms Maathai's work, though admirable, is only distantly related to the prevention of war. Skirmishes over pasture are common, but there is little evidence that environmental factors cause full-scale wars. Darfur is in flames more for political reasons. A group of guerrillas rebelled against an oppressive regime, which responded by slaughtering the rebels' ethnic kin. Planting trees in Darfur would not have saved its people.

The Peace Prize is often controversial. Those who stop wars are usually politicians; sometimes the same people who started them. Henry Kissinger's award in 1973 still angers many. Today, the politician who has arguably done the most to end the world's worst wars is South Africa's president, Thabo Mbeki, who was instrumental in pushing Congo and Burundi from utter mayhem to shaky peace. Ah yes, you say, but he has controversial views on AIDS.

So does Ms Maathai, as it happens. As she reiterated last week, she thinks the virus was created by “evil-minded scientists” to kill blacks: “It is created by a scientist for biological warfare.” Ms Maathai also argues that condoms cannot prevent transmission of the virus. Coming from one of the first women in east Africa to earn a doctorate, Ms Maathai's views might be seen as surprising. Coming from a freshly crowned Nobel laureate, they might be considered inexcusable.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Letters

Oct 14th 2004
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Providing pensions

SIR – You should worry less about the fate of ageing democracies ("Old Europe", October 2nd). As long as market-based economies underpin the wealth of the countries we all depend on they will adjust to an increasing proportion of older people. What we should worry about are institutional rigidities that will delay the necessary changes and make them more disruptive when they eventually happen. For example, entitlements to social-security pensions "bought" with contributions will need to be replaced by pensions paid from general revenue to people who need them. That sounds a lot worse than it needs to be.

The answer for Europe (or anywhere) is not compulsory private provision either. This is not really working in South America. Governments have a direct role in pensions—it is about social responsibility and the prevention of poverty among the old. It is not about telling people what to do. Pension reform will be achieved if we embed more market signals in both labour-force participation and age-related costs, such as health care. There will be creaks and groans but markets will adapt. There is no alternative. But I won't hold my breath waiting for politicians to say so.

Michael Littlewood
Auckland, New Zealand

SIR – You report that falling fertility rates in many European countries will lead to fiscal shortfalls over the next 20 years. The solution is obvious: tax contraceptives.

Stephen Mildenhall
Chicago

Language barrier

SIR – Your article about the recognition of Catalan as an official language in Europe and the polemic about Valencian misses two essential factors—linguistics and history ("Spanish practice", October 9th). Experts unanimously recognise Valencian as a variety of Catalan (as many Valencians call their language). Traditionally, Castilian or Spanish nationalism has used the artificial division of Catalan and Valencian as a way to divide and rule people who until the 18th century had their own kingdom, until the Aragón crown was suppressed violently.

Apart from Catalonia, Valencia, the Balearic islands, part of Aragón and Andorra, where it is the only official language, Catalan is also spoken in the south of France and in part of Sardinia. This should be enough to make Catalan an official language in the European Union.

Josep-Manel Mari
Barcelona

Regulation issues

SIR – We object to your characterisation of the accounting violations of Kookmin Bank and the censure for the bank's CEO as well as South Korea's business environment ("Bow down, or be cut down", September 18th). Rather than the "honest mistakes" to which you say many investors attribute the

bank's accounting violations, there was no question about what the bank should not have done with its books for the transactions the regulators cited. The violations were real and serious, and certainly not the type a bank of Kookmin's calibre should make. Nor was the censure issued to the bank's CEO "disproportionate". We have stressed repeatedly our intent to take an uncompromising stance against accounting misconduct to protect market integrity, and to demand managerial accountability. Our supervisory system worked as it should have and would have for any misconduct.

We must also vigorously object to your characterisation of South Korean companies' business practices as "somewhere between the clubby and the corrupt" and ask you not to confuse a few widely publicised bad apples with the rest. It is fallacious and besmirches all that we have accomplished to make Korea a genuinely transparent and investor-friendly market.

Oh Hong-Suk
International co-operation office
Financial Supervisory Service
Seoul

An ally in the war on terror

SIR – You fail to mention that in the five years that Pervez Musharraf has been president of Pakistan the economy has prospered ("The president's old clothes", September 18th). And he has played a difficult hand deftly by executing a policy shift that saw Pakistan closely align itself with the West in the "war on terror". But you rightly say that behind these accomplishments Mr Musharraf presides over a house of cards. He has ruled by diktat and failed to cultivate grass-root political support for his reform agenda. The ruling coalition comprises a coterie of politicians who have no credibility and are only interested in power.

I agree that the president would do well to give up his uniform and share power with secular and liberal political forces. This will broaden the base of his economic and foreign policy initiatives. The West, especially America, must impress upon Mr Musharraf the need to strengthen democratic institutions. But it might be expedient to support him at this stage of the war on terror. Only a democratic Pakistan with the full participation of political parties will be able to develop consensus to act as a bulwark against terrorism in the long term.

Ahmad Jalal
London

War and peace

SIR – Your survey of the European Union is skewed (September 25th). A theme is the avoidance of war in a continent which had too much of it for many centuries. This is looking backwards. The real point is that the EU is the only big economic or political entity in history that has been progressively created by consent, and without any use of military force to subdue or coerce dissident or reluctant partners. To that extent, Europe should now be proud, whatever problems and uncertainties arise from time to time and despite its own earlier bloody history, to have provided a unique and unprecedented model of a peaceful way forward. It represents hope, not only for Europeans, but for others too.

Tim Moore
Oxford

SIR – The people who run the European Commission are deluded if they believe that the golden age of peace and prosperity is directly linked to the rise of the EU. For the unvarnished fact is that the main threat—indeed the only real threat—to European peace in the latter half of the 20th century was never from internal squabbling among battered countries like France, Germany or Britain. It was from an aggressive Soviet Union. And the only thing that kept the peace in Europe was the political will and military strength of the United States. Yes, free trade among Union members led to economic growth but even that would not have been possible without America's sword and shield at the ready.

Peter Skurkiss
Stow, Ohio

Overheating

SIR – When an authority such as *The Economist* states that temperatures in Norway's arctic territory of Svalbard “can dip below 45°C” can anyone doubt the truth of global warming (“The big chill”, October 2nd)?

Stephen Parkin
Rotherham, South Yorkshire

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Australia's election

A prime minister with nine lives

Oct 14th 2004 | SYDNEY
From The Economist print edition

AP

For John Howard, a resounding vote of confidence from a booming country

Get article background

OPINION pollsters, political commentators and Australia's conservative coalition government itself, led by John Howard, all agreed that the country's election on October 9th was likely to be close. At best, the government would scrape home with a slashed majority; at worst there would be a hung parliament, with the opposition Labor Party possibly doing a deal with the resurgent Greens. All this turned out to be wrong. Within three hours of polls closing, the Liberal-National coalition had won a comfortable fourth term, with a voting swing of more than 2% and a possible majority of 24 in the 150-seat House of Representatives.

More than that, the coalition seemed to have won control of the Senate, the upper house, where small parties have held the balance of power for more than 20 years, frustrating governments at every turn. (Australia's complex system of second-preference votes means that the final results have been slow to trickle through.) A jubilant Mr Howard described the result as “stronger than I dared hope for”. In December he will become, at the age of 65, Australia's second-longest-serving prime minister after Sir Robert Menzies, his political hero and the man who founded the conservative Liberal Party, which Mr Howard heads. And he now has the chance to push through Parliament a series of economic reforms that could change the face of Australia.

The result stunned Labor and Mark Latham, its leader. At 43, after only ten years in Parliament and ten months as leader, the robust if unpredictable Mr Latham was seen as Labor's best hope of ending the coalition's nine-year hold on power. Mr Howard seemed vulnerable on health and education, issues where Labor led in polls, and particularly from attacks on his credibility over the government's unpopular commitment of troops to Iraq. Protesters dressed in rat suits hogged cameras at the prime minister's campaign appearances, reminding voters that one government senator had supposedly described Mr Howard as a “lying rodent” over intelligence failures before the war. In the end, though, little of this appeared to matter to voters.

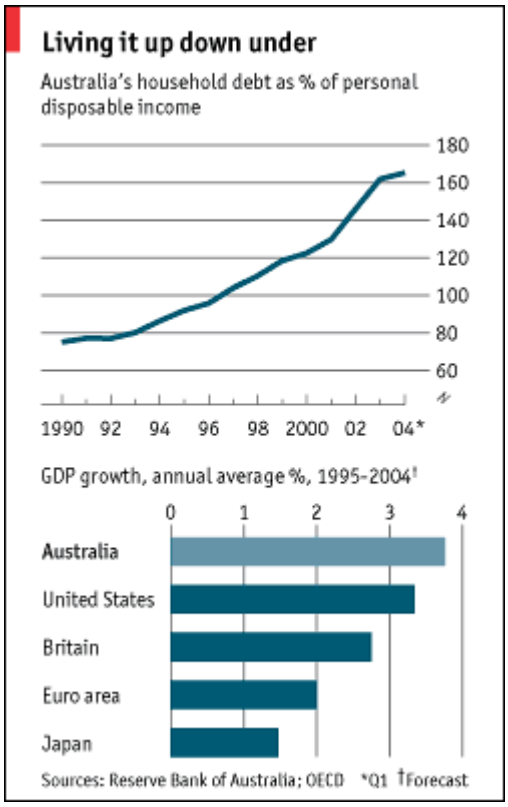
Mr Howard turned the issue of truth into one of trust, highlighting Mr Latham's inexperience as an economic manager. The prime minister's instinct for what is on the mind of suburban Australia is uncannily accurate. In 2001 he won an election he was expected to lose by painting Labor as weak on

security and asylum-seekers. This time, his target was interest rates. The coalition distributed handy ready-reckoners in key swing seats, inviting voters to calculate their extra monthly payments “when interest rates rise under Mark Latham”.

Since rates are set by the independent central bank, the tactic was odd, to say the least; but it worked. Mr Latham sadly understated matters, after a result even worse than that scored by his colourless predecessor, Kim Beazley, when he admitted that “economic policy is an area where we need to improve our stance and credentials.” Still, Mr Latham's job is probably safe. He is Labor's third leader in as many years, and the party is unlikely to be able to face looking for a fourth.

Mr Howard kept the campaign on the economy, where his solid record of achievement and a fear of what Labor might do to wreck it could only do him good. Mr Latham chose to focus, sometimes erratically, on social issues. In booming Australia, where people have saddled themselves with unprecedented debt largely on the back of soaring house prices, the voters that Mr Latham needed to woo were unprepared to take a risk.

Any doubters were probably swayed by images of normally Labor-voting timber-workers in Tasmania cheering Mr Howard two days before voting: he had promised to save their jobs after Mr Latham had pledged to end logging in the island-state's old forests. As a campaign ploy to win mainland green voters, Mr Latham's bid backfired: two of Tasmania's five seats, all Labor at the previous election, fell to the coalition. Overall, the government will probably net five seats from Labor since the last election; it has also consolidated its hold on others in suburban Sydney, which Labor once considered its heartland. It is likely to have 88 of the 150 seats in the lower house of Parliament, up from 82 after the last election. Labor will probably drop back to 60.



Friends, allies and bedfellows

The Greens, led by Bob Brown of Tasmania, increased their national vote at Labor's expense. But they will no longer be power-brokers in the Senate with the Democrats, a small centre party that was decimated. The coalition looks likely to be the first government to gain control of the Senate since 1981. It won half the Senate's 76 seats, and looked likely to snare one more. If not, Mr Howard is likely to explore a deal with Family First, a new religious conservative party, which is well placed to win at least one Senate seat.

Control of the Senate will at last allow Mr Howard to push through measures he sees as essential to his government's reform agenda, but which the Senate has blocked. One curbs unions' strike powers; another gives small businesses freedom to dismiss workers; a third lifts restrictions on foreign ownership of media companies and the dual ownership of newspaper and broadcasting outlets. The most contentious involves the sale of the government's 51% share of Telstra, Australia's biggest telecoms company. The stake is worth about A$30 billion ($22 billion) at current share prices; the proceeds would be used to lower public debt, already among the lowest in the world.

Family First may, however, need some massaging to make the Telstra sale a reality. The party has close links to the Assemblies of God, a Christian fundamentalist church, and is led by Andrea Mason, a lawyer and the first aboriginal to head a political party. She defines its policies as “family friendly”; the party opposes the Telstra sale, she says, because it could mean higher telecoms costs for outback and regional families. Family First has already sent signals that Mr Howard cannot take it for granted. It urged supporters not to give their second-preference votes to one coalition candidate in Queensland who supported gay marriage, or to another who is a lesbian. There could be trouble to come.

The prime minister is hardly likely to let this dent what he called his “very emphatic mandate”. Its scale undermines suggestions that Mr Howard might hand over the leadership to Peter Costello, his younger deputy, if he won a fourth election. “I'm not thinking about leaving,” he said. It is Mr Costello, not Mr Howard, whose future is now uncertain. As treasurer (finance minister), he has delivered all nine of the government's budgets, and has shown every sign of impatience to move on. The election has brought

two prominent Liberals into Parliament who could hog Mr Costello's limelight: Malcolm Turnbull, a rich Sydney businessman and banker, and Andrew Robb, a former Liberal Party director.

Like Mr Costello, both these men are republicans and are seen as more socially progressive than the prime minister, who still supports Australia's links to the British monarchy. In any event, whenever he retires, Mr Howard seems more minded to promote as his successor Tony Abbott, a fellow monarchist and social conservative. But the prime minister is now unlikely to bow out before the next election, due in 2007, unless there is a sudden glitch in the economy and he faces a backlash from the voters who have entrusted their economic security to him.

Spend, spend, spend

On the surface, such a glitch seems improbable. Australia's economy could hardly look in better shape. After 13 years of uninterrupted growth, having shrugged off shocks such as the East Asian crisis of 1997-98 and the global economic downturn in 2001, the “lucky country” seems unstoppable. But sooner or later it may run out of luck.

In the past three years under Mr Howard GDP growth has averaged more than 4%, the fastest pace of any big rich economy. But Australia's boom has been no one-day wonder: its growth has averaged almost 4% over the past 13 years as a whole. Unemployment is close to a 20-year low of 5.6%, down from a peak of 11% in 1992, or 8% when Mr Howard first took office in 1996, yet inflation remains well-behaved.

This stunning performance owes much to Australia's sound monetary and fiscal policies and to structural reforms, which (it should be noted) were started by a Labor government in the mid-1980s but continued by Mr Howard. Lower trade barriers, more flexible work practices and deregulation of product markets have boosted productivity growth and put the economy on a better footing to withstand shocks.

Mr Howard likes to claim much of the credit for the current health of the economy. Yet not only was much of the necessary work carried out well before his time, but Australia has also enjoyed a large helping of good fortune. One lucky break was that information technology (IT) accounts for a relatively small share of the economy. Australia thus avoided both the excesses of the tech bubble in the late 1990s and the damage of its subsequent bursting, which dragged America and several European economies into recession. IT firms accounted for only 15% of Australia's stockmarket capitalisation in 2000, when tech stocks peaked, compared with 45% in America. Today, while American equities are still languishing some 25% below their peak, Australian share prices have surged to record highs.

A second advantage of being an “old economy”, still largely dependent on commodities dug out of the ground, is that Australia has benefited greatly from China's economic boom, which is sucking in huge amounts of raw materials. Agriculture, minerals and fuels still account for more than half of all Australian exports: no other rich country is in so (currently) convenient a position. Australia now exports more to China than to America. Over the past five years its exports there have increased by 150% in US dollar terms; those to the rest of the world have gone up by just 20%. Not only has China imported increasing quantities of coal and metals from Australia, but its appetite for raw materials has sharply pushed up global commodity prices. As a result, Australia's terms of trade (the ratio of the prices of exports to imports) is at its highest level for 30 years.

Another prop for the Australian economy has come from a surge in house prices, which have risen by an annual average of 18% since 2000. This has made households feel wealthier, and so eager to spend. In turn, however, booming consumer spending has also sucked in a lot more imports, causing the current-account deficit to widen to around 5.5% of GDP.

The Economist's poll of forecasters (see article) expects Australia's GDP growth to slow to 3.3% in 2005; even the gloomiest forecaster expects growth of 2.8%. But the luck may not last for the whole of Mr Howard's next three years in office. One worry is that China's economy is overheating, and sooner or later its investment boom is likely to slow sharply, which would seriously curb Australian exports and commodity prices.

The biggest risk to the Australian economy is that the housing bubble could burst. House prices look dangerously overvalued, having soared to record levels in relation to both incomes and rents. Prices have already started to drop slightly in Sydney and Melbourne. Consumers are dangerously exposed to a big fall in house prices because of their reckless borrowing over the past few years. Since 1995, household

debt has increased from 92% of disposable income to more than 160%. And despite historically low interest rates, household debt service is now at record levels in relation to income.

Households have taken out bigger mortgages against the rising values of their property, allowing them to spend more than they earn. As a result, the household saving rate is now a negative 2% of disposable income. Even if house prices merely flatten off rather than fall, consumer borrowing and spending could slow sharply as people feel constrained to put more money aside.

The Reserve Bank of Australia has given repeated warnings about soaring debt and house prices, and arguably it should have raised interest rates by more last year. But a good slice of the blame for the housing boom must go to the Howard government which, in effect, slashed the tax rate on capital gains to half the top rate of income tax, luring a mountain of speculative money into property. At the peak of the housing bubble, as much as 40% of all new mortgage lending was for investment properties.

If consumer spending does slow sharply, then at least Australian policymakers, unlike those in the United States, have plenty of room to cut interest rates and taxes to cushion the economy and prevent a recession. Despite a large tax hand-out before the election, the government's budget is still in surplus and its total debt is only 18% of GDP, the lowest of any big rich economy. This is just one of the many ways in which Australia's economy has improved enormously over the past decade. But, as always during a boom, investors and borrowers have got carried away in the belief that the good times will continue for ever. They are almost certain to be disappointed. The next three years are likely to see much slower economic growth than the past three.

Tricky paths abroad

As well as managing an economy that may be entering rockier waters than the previous nine years have seen, Mr Howard will also have a tricky path to negotiate in foreign policy. If he is wise, he will resist the temptation to take the election result as an overwhelming endorsement of his focus on being good friends with America. There were too many signs that Australians felt uncomfortable about his commitment of troops to Iraq and his closeness to George Bush. The Iraq war provoked the largest demonstrations ever seen in Australia, even though the contingent of troops committed (about 2,000) was relatively small, and has since been cut to less than half—and, mercifully, has suffered no deaths.

To many of his critics, Mr Howard's robust concentration on his alliances with America and Britain was a sign that he had turned his back on the “Australia in Asia” policy of engagement with neighbours that was promoted by the Labor government of Paul Keating, his predecessor. In fact, this charge was always overdone. Mr Howard's government has taken its responsibilities in its neighbourhood very seriously. When East Timor descended into chaos in 1999, it was Australia that organised and led a UN-sanctioned peace-keeping force there. It did this despite the risk of angering Indonesia, from which East Timor was trying to break away, thus giving the lie to the accusation that Australia was interested only in cosying up to Suharto, Indonesia's dictator.

AP

Iraq was not an election-loser

Nor has East Timor been Australia's only intervention. It has also been active in Fiji, the Solomon Islands, Papua New Guinea and Vanuatu. It has signed pacts on free-trade areas with Singapore and Thailand in the past year or so, as well as an agreement on closer economic ties with the whole of the Association of South-East Asian Nations (ASEAN). In other words, Australia does not, and should not, have to choose between being close to America and being involved with Asia.

This is not to say that relations have been unruffled. Undoubtedly, Mr Howard incensed some of his neighbours—in Indonesia and Malaysia in particular—when, last year, he first spoke of Australia's right to take pre-emptive action against potential threats to its security. This summoned up the prospect of air strikes against Islamist radicals in *madrassas*, or religious schools, in those countries, and was furiously denounced. In fact, it is hard to imagine how such a thing could ever occur, not least because of the limitations of Australia's own armed forces. The government ever since has been at pains to point out that what was intended was (probably) an intervention in some failed or failing Pacific island micro-state.

Meanwhile, the election last month of Susilo Bambang Yudhoyono as Indonesia's president offers the

Howard government a chance to smooth things over with its nearest northern neighbour. Mr Howard's relations with Megawati Sukarnoputri, the outgoing president, were notoriously prickly. An opportunity to re-engage more sympathetically with the whole region will come next month, when Mr Howard attends summits of the Asia and Pacific Economic Co-operation group (APEC) in Chile and of ASEAN in Laos.

If Mr Bush loses his own election next month, Mr Howard's bigger foreign-policy priority will be to cultivate the same sort of rapport with John Kerry that he has had with America's 43rd president. But by confounding the pundits, Mr Howard, the re-elected war prime minister, may have offered Mr Bush some comfort for the days immediately ahead.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

After the debates

Down to the wire

Oct 14th 2004 | ST LOUIS, MISSOURI, AND TEMPE, ARIZONA
From The Economist print edition

Reuters

The three debates have helped John Kerry. But they also show each candidate pursuing a different audience and a different strategy

Get article background

JUST over two weeks to go. The race is tied. The differences are sharper. And new, very different strategies are emerging for running the final lap.

The three debates have changed the dynamics of the contest. Before them, George Bush was ahead in the horse race by five or six points, if you average out the polls. Just 39% of voters then said they regarded John Kerry favourably, compared with 53% who said the same of Mr Bush. Mr Bush was weak in the first debate, allowing Mr Kerry to win it convincingly; the second was something of a draw (though some saw a narrow Kerry win); and the third, on early impressions, went to Mr Kerry again. Both men are now regarded with equal favour and, in the *Washington Post*'s tracking poll on the day of the third debate, the challenger was ahead for the first time.

The debates highlighted the two men's differences. “There's a mainstream in American politics and you sit right on the far left bank,” jeered Mr Bush in their last meeting, in Tempe, Arizona. “The president is just trying to scare everybody here,” said Mr Kerry in the second debate in St Louis. “The president's wrong.”

The barbed personal exchanges reflect the growing tightness of the race and a sense of urgency among voters. This revealed itself most in the second debate, a town-hall meeting in which an invited audience asked questions. Often, these are respectful affairs in which supporters lob softballs. In St Louis, undecided voters hurled grenades. “Please explain how the spending you've approved and not paid for is better for the American people than the spending proposed by your opponent.” That was to the president. And: “Why are my rights being watered down?”

This sharpened the edge of the answers. So did the subjects to which the final debates turned: abortion, stem-cell research, the appointment of Supreme Court judges, gay rights. Even more than Iraq, these involve fundamental moral judgments, not calculations of interest.

The debates put different mindsets and different manners on display. Time and again, Mr Bush argued

that a good offence is the best defence, whether it be in Iraq, the war on terror, or tax cuts. After his unimpressive first outing, Mr Bush returned confident, eager and engaged. In St Louis, he waved. He gesticulated. He prowled the floor. He rediscovered lost good humour. He aimed to enthuse his base.

In contrast, Mr Kerry shared a platform three times in two weeks with the most powerful man in the world and emerged looking calmer, often the more “presidential”. He sang the virtues of co-operation, caution and planning. If he said “I have a plan” once, he said it two dozen times.

In the third debate, Mr Kerry drew thumbnail sketches of his policies on health care, raising the minimum wage, immigration policy and everything else that makes voters think he feels their pain and has ideas for doing something about it. But when Mr Bush was asked what he would say to someone who had just lost his job to outsourcing, he talked about “trade-adjustment assistance”, which fewer than one viewer in a thousand understands, and then turned to education. Mr Kerry usually gave plenty of details; Mr Bush, even when talking about Social Security reform (“a vital issue in my second term”), did not really explain his plans.

And where Mr Bush pleased his base, Mr Kerry sounded bipartisan (“I don't care whether an idea is a Republican idea or a Democrat idea”). He said he thought the president did “a terrific job” after September 11th (though he then went on to say that he had messed it up). He quoted the Bible (“Faith without works is dead”) and talked about being an altar boy.

Most of all, Mr Kerry mentioned Republicans throughout the three debates. He claimed to follow in the foreign-policy tradition of both Eisenhower and Reagan (surely very different traditions). On Iraq, he cited Republican senators Chuck Hagel and Richard Lugar. On stem cells, he cited Nancy Reagan. He mentioned John McCain at every possible opportunity. He talked about balancing the budget, claimed certain political labels (ie, “liberal”) were misleading and, turning to the camera, insisted he would not raise taxes on the middle class. “I'm fighting for the middle class. That's the difference.”

At the end, both parties expressed satisfaction with their champions. Mr Bush eviscerated his challenger's record—so Republicans claimed. Mr Kerry looked the part—so Democrats averred. Well, they would say that, wouldn't they? But there was more to it than spin. These comments reveal differing strategic calculations.

The president is seeking to stir up his base. After the first debate, he unveiled a new stump speech, harsher in its criticism of Mr Kerry than before. At a rally in Colorado Springs, headquarters of Focus on the Family, a large evangelical organisation, he emphasised his social conservatism: “We must support the institutions that give our lives direction and purpose—our families, our schools, our religious congregations. We stand for the culture of life...for marriage and family.”

The president is not even pretending to appeal to undecided voters. His rallies are all-ticket affairs, and tickets go only to volunteers or donors. Some have been asked to sign pledges of support and agree that their names be used as part of the campaign. Kerry supporters with the temerity to appear are ejected and have been threatened with jail (apparently for trespass).

Mr Kerry also has a new stump speech. It is full of domestic-policy concerns, economic details, job losses, health care and, inevitably, praise for “hard-working middle-class families”.

In other words, the differences at the debates reflect different calculations about the last stage of the race. The Democrats think the contest will be won, as so often, in the middle; so they are reaching out to swing voters. Republicans think the race will be won by whoever turns out his core supporters more successfully; they are reaching out to social conservatives.

Both these strategies have a colour of plausibility. Mr Kerry's is the more conventional and, as the narrowing race shows, it seems to be working better. Crucially, Mr Bush's support has fallen below 50%. This matters because of the so-called “incumbent 50% rule”. The rule says that the percentage of the vote a sitting president gets in polls is a better indicator of the state of the race than the margin. Guy Molyneux, a Democratic pollster, points out that in the past four elections with a sitting president, the incumbent's actual vote was almost exactly the same as his final polling number. But the challenger got an average of four points more.

So an incumbent polling less than 50% is in serious danger while a challenger with more than 46% is in better shape. Mr Kerry is at 46% and rising while Mr Bush is somewhere around 49%. Mr Kerry is therefore pinning his hopes mostly on swing voters—talking of his faith, luring back women voters

(“women work for 76 cents on the dollar for the same work men do. That's not right in America”) and insisting he is a budget and security hawk, not a weak-willed socialist flip-flopper.

As for the Republicans, it must be said they might find it hard to appeal to the middle even if they wanted to. Disapproval of the Iraq war and the state of the economy are just too high.

Yet the strategy they have adopted is compelling. The “50% incumbent rule” worked in the past because undecided voters had made up their minds early not to vote for the incumbent but did not decide in favour of the challenger until the last minute. But this time, there are fewer undecideds than usual; they may not vote at all; and if they do, they make not break to the challenger for fear of changing the commander-in-chief in mid-war. Almost every president who fought a re-election campaign in wartime has won.

In the 2002 mid-term elections, Republicans won 51% of the vote for the House of Representatives. In September, at the height of his post-convention rally, Mr Bush's re-election numbers hit 52%-55%. In contrast, Mr Kerry's support has been above 50% only once since March. That suggests the Republican base is not only bigger than the Democratic one but may be big enough to win Mr Bush re-election without any swing voters—if he can turn out his base. His job, therefore, is to rally the troops by looking confident, stressing social conservatism and attacking his opponent mercilessly.

Election day will show which of these strategies was right. For the moment, all that can be said is that the momentum seems to be moving slightly towards Mr Kerry, that the match looks even and that the last stage of the race has become a competition between turnout and swing voters. After the St Louis debate, the 140 uncommitted voters who formed the audience were asked if the clash of candidates had helped them make up their minds. Most of them said no.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Getting out the black vote

Don't blush, just flush

Oct 14th 2004 | LITTLE ROCK, ARKANSAS
From The Economist print edition

A technique from which only Democrats benefit

TRUCKS and vans move slowly through black neighbourhoods. Black youths hop out to knock on doors. “Have you voted yet? No? Get in the van.” The would-be voters do and, when the van is full, they ride to the voting-place. Then the van rolls to another street. A scene from Haiti? No: a common sight in America's south on election day.

Down there, many Democratic candidates, though they rarely talk about it, still pay “love offerings” or “walking-around money” to leaders of the black community. Love offerings, which may be a few hundred dollars or several thousand, are “spontaneous” acts of charity given to the church of an influential black minister with the tacit understanding that he will put a cautious stamp of approval on the candidate. Churches cannot officially endorse a candidate, for fear of losing their tax-exempt status. But a minister can praise the candidate in front of the congregation, let him speak from the pulpit, or maybe give him a list of the church's members.

Then there is “flushing and hauling”. Quail-hunters flush birds out of the bushes and into the air, where they can be shot. In southern politics, an enterprising campaign manager will recruit well known “organisers”, brandishing a golden hello in a brown envelope; the organiser will pocket some of the money and give the rest to friends who, on election day, drive those vans into black districts to flush people from their houses. Do they tell them how to vote? Not exactly, but the van usually contains lots of leaflets promoting Democratic candidates. The result: the number of voters shoots up, and the Democrats get most of the extra votes.

Republicans would doubtless do the same if they thought it would help them. The fact is that expanding the black vote benefits Democrats far more that their rivals. Of every ten extra black voters, nine will vote Democratic. And the average Republican voter doesn't have as hard a time reaching the polling station as poor blacks do, especially in rural areas. (Most Republican dirty tricks in these parts focus on stopping black voters getting to the polls—sometimes even telling them the wrong day.)

Flushing and love offerings are both hard to prove; but several of the south's better-known Democrats have reputedly been masters of the sport. Mr Kerry is obviously an upright New Englander; but his less scrupulous supporters in the south will most likely be keeping the tradition alive.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The corporate tax cut

Lobbyists' delight

Oct 14th 2004 | WASHINGTON, DC
From The Economist print edition

America's tax policy hits a new low

ANOTHER week, another irresponsible tax bill. On October 11th, exactly seven days after George Bush signed his fourth tax cut into law, Congress passed another mammoth tax bill, this time focused on corporate taxation.

The new law started life as a laudable effort to get rid of a $5-billion-a-year tax subsidy for exporters that the European Union had complained about and the World Trade Organisation had deemed illegal. But it has ended up as a 650-page horror that adds endless complexities to the tax code and doles out favours to a cornucopia of special interests from tobacco farmers to bow-and-arrow makers. With no hint of irony, the bill is officially called the “American Jobs Creation Act of 2004”. John McCain's famous description of the stalled energy bill as the No Lobbyist Left Behind Act could equally apply here.

Trying desperately to look on the positive side, the bill does indeed phase out the subsidy that the WTO disliked. Known as the “foreign sales corporation” subsidy, this will be eliminated over the next two years. Companies that currently gain from this will get 80% of their benefit in 2005 and 60% in 2006. That should prompt the EU to get rid of the WTO-sanctioned retaliatory tariffs it had started imposing in March; these, which have been rising month by month, have now hit 12%.

The problem comes in the measures the bill deems necessary to make up for the shocking withdrawal of the subsidy. Under the new law, all domestic manufacturers, not just exporters, will get a tax break that effectively lowers their corporate tax rate from 35% to 32%. And the definition of manufacturers is hardly constricting. Farmers, Hollywood studios and architects, among many others, will all be eligible for the handout.

And just in case this did not add enough complexities to America's labyrinthine tax code or give away enough goodies to hard-pressed firms, the corporate bill packs in countless more. It allows taxpayers in states with no income tax to deduct sales taxes from their federal tax bill (something that Ronald Reagan's 1986 Tax Reform Act got rid of). It offers a tax holiday for companies that repatriate their foreign earnings this year or next; and it extends the “temporary” investment incentives for small businesses that Mr Bush promoted in 2003.

Most egregious, though, are the boxloads of special favours for industries from timber producers to cruise-ship owners. The biggest is a $10 billion buy-out of tobacco farmers' quotas, but, in truth every industry with even a half-decent lobbyist on K Street in Washington, DC, gets something, be they Native Alaskan whaling captains or race-track owners.

Officially, all this largesse is made up for by the closure of tax loopholes (of which there are indeed a few) and the fact that many tax breaks are temporary. The sales-tax break, for instance, officially lasts only a couple of years. As a result, the Joint Committee on Taxation claims that the corporate tax bill is revenue neutral. But if recent history is any guide, the temporary tax breaks will surely be extended. And if all such breaks are extended, the Centre on Budget and Policy Priorities, a budget-watching think-tank, reckons the corporate tax bill will cost almost $80 billion over the next decade.

To his credit, John Snow, the treasury secretary, made clear that he did not think much of the special giveaways in this bill. But no one expects Mr Bush to veto it (as *The Economist* went to press, he had not yet got round to signing it). The bill may stink of pork, but the Republicans' enthusiasm for bacon will only have been heightened by the closeness of the election.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The electoral week

On the trail

Oct 14th 2004
From The Economist print edition

The big issue

“It must have been a pucker along the back seam, accentuated when he crossed his arms and leaned forward.”

George Bush's tailor explains the bulge in the president's back spotted during the debates. Miami Herald, October 9th

Isn't that how Lincoln won?

“I don't think the American people are going to choose a president on the basis of facial expressions.”

Karen Hughes, a Bush spindoctor, spins The Early Show, CBS, October 8th

Does he know something we don't?

“Clearly, we should be more worried today, actually, about Iran and North Dakota than we are—North Korea—than we are about Iraq.”

Pete Coors, brewer and Senate candidate in Colorado, broadens the “axis of evil”. Meet the Press, NBC, October 10th

The loneliness of the running-mate

“Asking to run with [John Edwards] is like asking to take a shower with him.”

An aide on the Democrat's need for privacy. Runner's World, November issue.

Appealing to America's youth

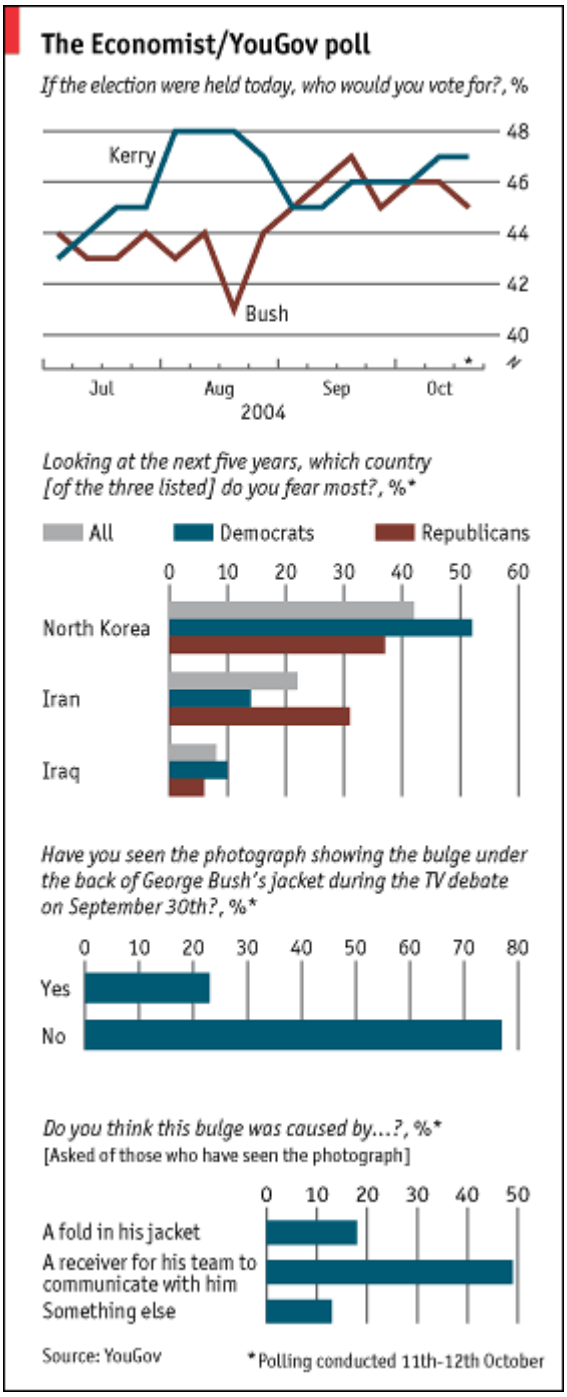
“Voter-registration forms need to be places where young people are going to see them [like] pornography and cigarettes and condoms—places where they can't miss them.”

Jake Gyllenhaal, Hollywood heartthrob, knows how to get young Americans to vote. New York Daily News, October 12th

The Canadian threat

“When a drug comes in from Canada, I want to make sure it cures you and doesn't kill you.”

George Bush on why he is wary of dastardly Canadian prescription drugs in the presidential debate, October 8th



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The nastiest race in Texas

Stripped for action

Oct 14th 2004 | DALLAS
From The Economist print edition

The Republicans target a pugnacious Democratic congressman

AP

And my free spirit was this big

Get article background

WHAT'S a little nudity between friends? Democrats have been joyfully circulating newspaper clippings of a mass streak by students at Southwest Texas University in 1974. Their reason for doing this is that one of the jovial nudists was the 18-year-old Pete Sessions, who explained then that taking off his clothes was “a free spirit thing”. Mr Sessions is now a conservative Republican congressman stuck in a battle royal with a veteran Democrat, Martin Frost, for a redistricted seat in Texas.

Mention of redistricting is where the tale begins to turn nasty. The Republicans blame Mr Frost for the penultimate bout of boundary-fixing back in 1991, which helped give the Democrats a 17-15 advantage in the Texan delegation. Last year, Mr Frost's arch-enemy, Tom (“The Hammer”) DeLay, the Republican majority leader in the House, readjusted the boundaries again, intending to ensure not only that there would be a five-seat Republican majority (at least) in the delegation after November's election, but also that Mr Frost would face a particularly tough fight. Mr Frost, according to Mr Sessions's campaign manager, “would have been naïve not to believe he wouldn't be paid back”.

In all, Mr DeLay selected seven Democrats for the chop. A year later, only five remain. One conservative Democrat, Ralph Hall, has jumped over to the Republicans; another, Jim Turner, from east Texas, is standing down before he can be beaten. Of the vulnerable five, Chet Edwards in the 17th district stands a chance of surviving, not least because his opponent, Arlene Wohlgemuth, is extreme even for many Republicans. In the 19th district, Charles Stenholm, a conservative “boll-weevil Democrat” with 26 years in Congress, may just squeak through. The hopes of Max Sandlin, in the 1st district, and Nick Lampson, in the 2nd, probably depend on the defects of their opponents.

But the biggest scalp would be Mr Frost. His 26 years in the House have been spent representing a district most of which lies on the wrong side of the Dallas railway tracks and is 38% Latino, 22% black and only 35% “Anglo”. His old district has now been merged with Mr Sessions's Republican stronghold in North Dallas. This area—with its tree-lined avenues and the well-manicured Dallas Country Club—tends to warm to Mr Sessions's anti-government message. The latest poll in the *Dallas Morning News* gives Mr Sessions a six-point lead.

However, as the streaking pictures show, Mr Frost is not giving up without a fight. He has plenty of money (both men have raised more than $3m so far), and he is a more articulate campaigner than his rival. Mr Frost claims that North Dallas may not be as Republican as it seems; there is no voter-registration by party in Texas, but “you can tell by the primaries that a majority of North Dallas are not voting in them.” In other words, that silent majority may be up for grabs; and for the first time since 1970 they will have a “serious Democratic candidate”. His plan is to push up the black and Latino vote (minorities account for almost half the new district's population) and to persuade affluent North Dallas-dwellers to “split their ticket”, voting for both their erstwhile neighbour, George Bush, and for Mr Frost.

That is a tall order, but not an impossible one. Mr Frost points out that North Dallas includes the city's Jewish community, and he is the only Jewish congressman in the whole state. According to his reckoning, Jews will account for 10% of the turnout—and he expects four-fifths of their votes. Mr Frost's other assets include one of America's few female generals as his wife, a strong record on bringing defence contracts and other pork back to Texas, a relatively conservative record in Congress (he is best known for a tough law punishing child-molesters) and the fact that Mr Sessions is fairly strong meat even by Texas standards. So extreme is his devotion to small government that he was one of just nine House members to vote against the airline-security bill in November 2001.

Will Mr Sessions's teenage nudity help Mr Frost? The president's own career suggests that Texans are relatively tolerant of youthful misdemeanour, but Mr Sessions is open to the charge of hypocrisy: he seemed to forget the “free-spirit thing” when he led the criticism of Janet Jackson, whose breast made a free-spirited appearance at the Superbowl.

Should Mr Frost somehow manage to deny Mr DeLay his revenge, it will not be the only slight the Hammer has suffered recently. Three times within two weeks the House ethics committee has rebuked the Republican leader for being over-aggressive in his pursuit of corporate donations and political advantage. Meanwhile, three of Mr DeLay's aides are being investigated in Texas for the illicit use of campaign funds. Mr DeLay has dismissed the fuss as “frivolous” and partisan.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

South Carolina's Senate race

Big ideas and bigotry

Oct 14th 2004 | GREENVILLE
From The Economist print edition

The most intellectually riveting Senate contest in the country

THE night before John Kerry and George Bush faced off in Arizona, two other candidates stood behind their lecterns in the studios of a local television station in South Carolina. Jim DeMint, a Republican congressman, and Inez Tenenbaum, the state's education boss, held their second of six debates. There was less razzmatazz and fewer spin-doctors than in Arizona, but perhaps more substance. The candidates sparred on fundamental tax reform, trade relations with China and Social-Security privatisation—and that was just in the first 20 minutes.

The battle for the Senate seat being vacated by Fritz Hollings, an old-style southern Democrat, is the most expensive in the state's history. Republicans have long counted on picking up a second seat in this staunchly conservative state; it may be crucial to them controlling the Senate. But it is also one of the most intriguing in terms of ideas: this is a race where a big issue has been the merits of replacing the tax system with a 23% national sales tax. Meanwhile, a state known both for its social conservatism (this is the home of Bob Jones University, which used to ban inter-racial dating) and its protectionism (South Carolina was once the textile capital of the world) must now choose between the two.

The reason is Mr DeMint, an affable former advertising man, who has turned traditional campaigning norms on their heads. Rather than paying homage to the textile barons, he is an unabashed free-trader who has called them “malcontents and hypocrites”. He points out that 25% of South Carolina's jobs are tied to exports and that the state is one of the most reliant on foreign investment creating jobs. In 2001, he cast the decisive vote that gave Mr Bush trade-promotion authority.

The boldness goes well beyond trade. Mr DeMint wants to change the tax code radically (he has backed 11 bills in Congress that push reforms from the flat tax to a sales tax); he has sponsored an ambitious bill to create personal retirement accounts; and he has pushed hard for health-savings accounts. Small wonder that he is the darling of Washington's conservative think-tanks.

At the same time, Mr DeMint is fiercely socially conservative. Pro-life and pro-gun, he caused a ruckus in the first debate when he argued that gay people should not be allowed to teach in public schools. Ms Tenenbaum said this was unAmerican, but two days later he added that pregnant, unmarried women should not be allowed to teach either. He later apologised, but he has left no doubt about his ultra-conservative credentials. This is no accident. Part of the DeMint strategy is to portray his opponent as too liberal for South Carolina.

Ms Tenenbaum denies that adamantly. A popular figure in the state, she supports gun-rights, the war in Iraq and a constitutional amendment to ban gay marriage. But most of all, she casts herself as an economic populist. She rails against trade agreements with China, claims that 42,000 more textile jobs will be lost unless quotas on Chinese imports are extended and pledges never to sign a trade deal that would cost any South Carolinian jobs. Not surprisingly, the textile titans have lined up behind her.

At the same time she denounces Mr DeMint's “extreme” ideas on tax and pension reform. She has hammered him for co-sponsoring a law to replace the federal tax code with a 23% national sales tax. With well-staged events in grocery stores and a television advertising barrage, Ms Tenenbaum has tried to convince South Carolinians that her rival wants them to pay 23% more at the shops (cleverly forgetting to add that such a tax would replace all other federal taxes).

Mr DeMint's fate could have national implications. Just as proposals to privatise Social Security became less outlandish after Mr Bush mentioned it in 2000, so radical tax reform and free trade will get a big boost if Mr DeMint wins. A DeMint loss, by contrast, bodes ill for reform ideas.

A big DeMint lead in the summer has disappeared; a recent survey even put Ms Tenenbaum in the lead. But the Republican has a trump card: Mr Bush. Mr DeMint misses no chance to tie himself to the popular president, while Ms Tenenbaum constantly distances herself from John Kerry. Even John Edwards, who was born in South Carolina and is the Democrats' most effective populist, has been to the state only once recently. For all Mr DeMint's unorthodoxy, Ms Tenenbaum has a chance only if she denies her own party.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Getting out the vote

Bush people

Oct 14th 2004 | NEW HOLLAND, PENNSYLVANIA
From The Economist print edition

The Amish love the president; will they vote for him?

THE Amish tend to shun newfangled things—electricity, cars, modern clothes, presidential politics. Only about one in ten vote. But their conservative Christian values and suspicion of big government make them natural adherents of the right. As the Amish put it, “We don't vote, but we pray Republican.”

Republicans have been courting the Amish in the battleground states of Pennsylvania (where there are 50,000 of them) and Ohio (54,000). The election boards in Lancaster County, Pennsylvania, and Holmes County, Ohio, have seen a surge in Amish names among those registering to vote. If even a few thousand of them were to horse-and-buggy it to the polls in either state on election day, it could make all the difference to George Bush in a neck-and-neck race.

The president met privately with a small group of Amish in Lancaster County in July. Ever since, the local party faithful have been chasing the Amish vote, even offering to drive them to the polls. A handful of Amish themselves have jumped on board: Aaron Beiler, who runs a farm market, has distributed hundreds of voter-registration forms to Amish farms and businesses. Informal voter-drives are under way in Holmes County, too.

The Amish seem to feel that one of their own is in the White House. “He comes from the old school,” one says. Mr Bush's foreign wars do not accord with Amish pacifism, but his religious conviction and his stance on social issues have got their hearts aflutter. They see gay marriage as an affront to their way of life; the president's opposition to abortion “puts warm circles around our hearts”. Even Mr Bush's wild past resonates: Amish teenagers are known to sow their oats before returning to the church.

Some church leaders are still cautioning against voting. But ultimately the church leaves voting up to the individual. An Amish historian in Lancaster says that his people used to vote in greater numbers: they came out to defeat the Unitarian Adlai Stevenson, when he ran against the more godly Dwight Eisenhower in 1952, and in 1960 they voted against the Catholic John Kennedy, because his church oppressed their European forebears. John Kerry is seen as so liberal that his Catholicism is the least of his problems.

The Republicans have to push softly. Already, Mr Kerry's supporters have accused them of trying to exploit the Amish. Others have wondered why the Amish, who have been conscientious objectors in past struggles, should support a warmongering president. One danger for the Amish of entering politics is that they may draw criticism for the privileges they have won to maintain their way of life—such as exemption from Social Security taxes—or simply draw attention to themselves.

As with many other Americans, voting is not always a priority. November is the Amish wedding season, and election day falls on a popular day to get married. “If I hitch my horse there at the wedding,” one man complains, “there's no way I'm going to make it all the way back to vote.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Lexington

Last chance for the Democrats?

Oct 14th 2004
From The Economist print edition

The presidential election says a lot about the unequal state of America's two parties

IT IS hard not to become fixated on personalities in the final stages of a presidential campaign. Is George Bush too pig-headed to be trusted with another four years? Is John Kerry too much of a flip-flopper? Did Mr Bush's peevish expression in the first debate display his real nature? Or is his folksy charm still preferable to Mr Kerry's Brahmin condescension? But presidential elections are not just tests of the character of the individual candidates. They are also tests of the character of the parties they lead. And this year the two parties present a study in contrasts.

The most obvious concerns momentum. Momentum in the presidential race may shift from day to day, but momentum in the battle to become America's dominant party seems to be largely in the Republicans' direction. Forty years ago, Democrats outnumbered Republicans by two to one. Today they outnumber them by just a few percentage points. Forty years ago the Democrats had a lock on Congress. This November the Republicans have a good chance of retaining control of both the House and the Senate. Forty years ago the Democrats set the political agenda. Today the Republicans are a much more fertile source of ideas on everything from foreign policy to school reform.

A second contrast lies in organisation. The Republican Party seems to be organised like a blue-chip corporation: directed from the top and tightly disciplined. The Democratic Party is much more of an “adhocracy”: a collection of groupuscules that have come together for the single purpose of winning this election.

Nowhere is this clearer than in the ground war. It is generally agreed that the big prize this year will go to whichever party does the better job of getting its supporters to the polls. To this end, the Republicans have reinvented the traditional political party for the age of suburban sprawl. The party boasts an elaborate hierarchy of activists—state chairmen, county chairmen, precinct captains, local volunteers—who all have a pre-assigned role in a plan laid down in the Bush-Cheney headquarters in Arlington, Virginia. By contrast, the Democrats—ironically, given their opposition to outsourcing—have handed over most of the grunt work of registering and mobilising voters to independent groups such as MoveOn.org and America Coming Together.

This difference is partly a function of campaign-finance law: the Democrats have been much busier exploiting loopholes in the McCain-Feingold legislation to form nominally independent organisations,

known as 527s (after part of the tax code). But it has much deeper roots: the Republicans are now much more interested than the Democrats in building up their party.

Mr Bush is one of the most enthusiastic party-builders to have occupied the White House. Several earlier presidents deliberately snubbed their parties: Richard Nixon pursued a strategy of “lonely victory” in 1972, while Bill Clinton adopted a policy of “triangulation”, adopting whatever Republican ideas seemed likely to win votes. George Bush senior didn't so much snub his party as ignore it. But his son threw all the prestige of his post-September 11th presidency behind campaigning for congressional Republicans in 2002. He has worked closely with other party-builders on Capitol Hill, particularly Dennis Hastert and Tom DeLay in the House and Bill Frist in the Senate.

Meanwhile, the Democrats' party organisation is fraying. For decades the labour unions have provided both shoe leather and organisational glue for the Democrats. But the proportion of the workforce belonging to unions has shrunk from 30% in 1950 to 13% today. Trial lawyers have replaced trade unionists as the party's main paymasters, but they are too few in number (and too busy) to hold the party together in the same way. Women and black groups are also too focused on their own interests. The party was losing ground to single-issue pressure groups even before the 527s came along.

The lesson from Tony Blair

These differences in momentum and organisation make a bigger point: the Republicans have more to gain from a victory in November. Because the election is largely a referendum on Mr Bush, he can claim, if he wins, a clear mandate for his policies—particularly cutting taxes at home and smiting terrorists abroad. If Mr Kerry wins, the only mandate he will have will be for not being George Bush. In 1993, Mr Clinton had a difficult enough time holding his party together despite laying out a compelling vision of a new Democratic Party. The singularly unvisionary Mr Kerry will have to deal not just with the same struggles (for instance, between health-care reformers and deficit hawks) but also with a new civil war between the party's rabid Michael Moore faction and its more sensible Tony Blair wing.

The second reason why the Republicans have more to gain from a victory in November is that they think they can use a second Bush term to turn themselves into America's de facto ruling party. Grover Norquist, the head of Americans for Tax Reform, may be exaggerating when he says that “the Democratic Party is toast” if Mr Bush wins. But the Republicans have put emasculating the Democrats at the very heart of their second-term agenda. They plan to reduce its footsoldiers by contracting out hundreds of thousands of federal jobs, to reduce its income through tort reform (which may slim down the lawyers' wallets) and right-to-work laws (which will allow workers to opt out of union dues). And they plan to boost the number of people who own shares—and hence a stake in the success of the capitalist system—by beginning to privatise Social Security.

The Republican aim is to do to the Democrats what Mr Blair has so successfully done to the Tories in Britain: marginalise them so completely that they degenerate into a parody of a political party. No wonder the Democrats are fighting so hard this year. And no wonder they hate the party-builder in the White House with such a furious passion.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Life in Cuba

Small business just got smaller

Oct 14th 2004 | HAVANA AND TRINIDAD
From The Economist print edition

Reuters

A new campaign against private enterprise comes as Cubans suffer from worsening water and power shortages

Get article background

SINCE the collapse of communist Cuba's main benefactor, the Soviet Union, in the early 1990s, and the withdrawal of its subsidies, Fidel Castro's regime has stumbled along in what the government has euphemistically called the “special period”. Its main special feature has been the limited opening-up of the economy, most notably to foreign investment in the tourist sector, to bring in vital hard currency. According to the UN Economic Commission for Latin America and the Caribbean, tourism earns Cuba about $3 billion a year.

An even more special innovation, however, was the decision in 1993 to allow Cubans limited freedom to set up small private businesses in 157 spheres of activity. Originally, the scheme was a huge success, leading to a quick expansion in the number of small firms. But the rules have since been tightened, and new ones that came into force at the start of this month mark another important stage in the clampdown. To many, it looks like an ominous sign that Mr Castro is going to try to preserve the original ideology of the revolution, now 45 years old, to the very last.

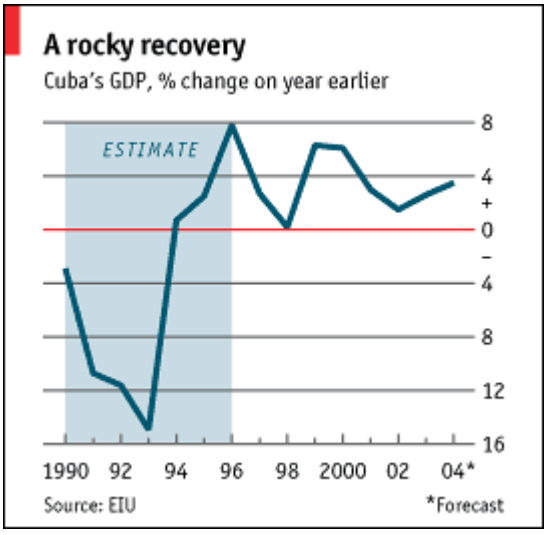
The most popular forms of private enterprise are *casas particulares*, houses that rent out rooms to paying guests, and *paladares*, restaurants run out of houses. Payment is in dollars, and the regulations are always onerous. *Paladares*, for instance, can have a maximum of 12 seats and may serve only certain kinds of food; even their light bulbs must not exceed a certain wattage. But in a country where many imported products are available only at higher-than-American prices, the extra income is badly needed. According to official figures, 209,000 small businesses had been given licences to operate by 1995.

But there are no illusions that Mr Castro regarded these small businesses as anything other than a necessary evil. So since the end of the 1990s, the regime has tried to make life as hard as possible for them. One sign of this is the swingeing taxes that would-be entrepreneurs have had to pay to the government—monthly, up-front and regardless of income.

Carlos, for instance (not his real name), runs a *casa particular* in the pretty colonial town of Trinidad, a popular tourist destination on Cuba's south coast. He has to pay a monthly tax of almost $400 on rooms that rent for about $20 a night, and which often go unfilled for weeks during the low season. He makes barely any money on the business, but runs it “because there is nothing else to do” in the town. Like other young people, he dreams of going abroad, in his case to Germany. With these sorts of disincentives, it is little surprise that the number of registered small businesses began falling, down to 154,000 by the end of 2001.

Now, however, there is even less to do for the aspiring entrepreneur. The new regulations certainly have an unintentionally comic side that only po-faced state bureaucracies can manage: you can no longer get a new licence to be a clown, a magician or a masseuse for private gain. But less funnily, no new *paladares* will be allowed to open, and existing ones will be even more restricted in what they can serve: even potatoes are off. Altogether, some 40 areas of small business are affected by the new rules.

Why has the government decided to tighten the screw on private enterprise now? In the usual absence of any official explanation, there has been plenty of speculation. One dissident argues that Mr Castro knows only too well that “when you are free economically, you are free politically”, and so has taken an opportunity to snuff out this particular threat to the regime. Certainly, this would seem to chime with the political crackdown of spring 2003, when scores of dissidents were jailed in the biggest such round-up since the 1960s. “No surrender” would seem to be the regime's rationale.



Others argue that Mr Castro thinks that the reforms of the special period have achieved their aim of stabilising the economy, so he can now dispense with these extra sources of hard currency. But though official figures show modest but steady growth in recent years (see chart), they seem to fly in the face of on-the-ground economic realities.

Among other woes, such as the sharp decline of the state-run sugar industry, in recent weeks Cuba has been plagued by power cuts lasting for many hours at a time—the worst in ten years, some say. Usually, all economic problems are officially blamed on the “genocidal” American blockade. But so obvious has the energy crisis become that Mr Castro has been on television no fewer than three times admitting to “errors” in the handling of the energy situation. The creaking electrical-supply system is starved of investment to carry out urgently needed repairs, as is the water-supply system. The result is water shortages in some parts of the island.

Remittances from Cubans living abroad still provide a steady source of income to the island, estimated at $900m a year now. But the squeeze on private enterprise means the further erosion of one of the few means that Cubans in Cuba had left for exerting control over their own destinies. Amid the pervading economic gloom that now envelops the country, that small freedom counted for a lot.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Bolivian politics

Goni gone, but not forgotten

Oct 14th 2004 | LA PAZ
From The Economist print edition

Bolivia's president performs a tricky balancing act

Reuters

Mesa prefers courting civic groups

WAVING rainbow-coloured flags, 3,000 people set off on a 150km (94-mile) march this week to La Paz to demand the arrest and trial of Gonzalo Sánchez de Lozada—"Goni", as Bolivians universally call the former president and millionaire mining magnate. The first anniversary of his flight to exile in the United States was expected to pass peacefully. The question is how long the peace will hold for his successor, Carlos Mesa.

Goni fled on the 17th day of what has become known as "Red October"—partly in honour of the leftist ideologues who organised demonstrations against him and partly in memory of the 59 people killed after he ordered troops on to the streets. Since 1985, as he rose from being a senator to a minister and then (twice) president, Goni had been instrumental in introducing policies to correct a bankrupt state, outdated institutions and a moribund and increasingly corrupt set of national industries. All were overhauled or handed to the private sector. But while the reforms were good for investors and businesses, few ordinary Bolivians saw quick benefits. Over the past four years, earnings per head have shrunk, privatisation has become a dirty word and populist nationalism has come back into fashion.

Mr Mesa, Goni's one-time vice-president, therefore walks a tightrope. An independent without a party, he has been unable to assemble a governing coalition in Congress. He has chosen instead to juggle political forces, sidelining unpopular political parties that supported Goni and the privatisations, but courting civic groups.

That has boosted his popularity, but it makes governing tricky, since Congress effectively contains neither a government block nor an opposition. The political parties, struggling to revive their fortunes, says Gonzalo Chávez of the La Paz Catholic University, "are fragmented and have no detectable policies". Most are focused on trying to recover their popularity ahead of municipal elections in December.

Given these conditions, Mr Mesa has not done too badly on keeping four promises that he made when he came to power. He has not used armed repression. Against stiff odds, he has held a referendum on a new oil and gas policy (which stops short of renationalising oil companies but does impose higher taxes on them). An oil law, to replace one introduced by Goni in 1996 to underpin privatisation, is wending its way through Congress. And an assembly with powers to draft a new constitution, which will give more recognition to the interests of the country's poor Indians, is to be held in the middle of next year.

Luck has also been on Mr Mesa's side. After four sluggish years, GDP growth could reach 4% in 2004, as world prices for most Bolivian commodity exports are up. Tax reforms passed by Goni are starting to have an effect. Mr Mesa has taken them further, as well as cutting spending. That has allowed him to curb a ballooning deficit that threatened to leave teachers and hospital workers unpaid.

Ironically, Mr Mesa's biggest challenge may be Goni himself. Last month the ex-president made his first appearance on Bolivian television since his escape. He called for "truth and reconciliation", but also spoke of the need to "get to the bottom of the parts played by all the different actors", a jab at protest leaders for inciting rioters. He also denied rumours that he stole money from the country's central bank.

The speech played badly in Bolivia, however. The growing calls for Goni to be put on trial could become a rallying cry for further unrest. A congressional commission has ruled that he should face charges. The protesters who helped oust him formed a political movement, M-17, which is seeking recognition as a political party. “The protest groups are too busy worrying about their candidates' chances in December's local elections to do anything now,” says Álvaro García Linera, a former guerrilla turned political analyst and co-author of a new book on Bolivia's social movements. “They will be back, though, in 2005.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Guatemala's civil-war victims

Holistic healing

Oct 14th 2004 | MOMOSTENANGO
From The Economist print edition

A better approach to civil-war recovery

IT HAS been eight years since peace accords were signed in Guatemala, ending a 36-year civil war that left 200,000 people, mostly Mayan Indians, dead and a million uprooted. Yet the western highlands, where the war raged most, remain a backwater. Malnutrition, infant mortality and illiteracy are rampant. Many villages lack running water and electricity.

Less visibly, the killings, kidnappings, bombings and rapes over three decades—by both soldiers and paramilitary "civil patrols" or PAC, some of which still operate unchecked in rural areas—have left indelible psychological scars. At the end of last month Kofi Annan, the UN secretary-general, said that a "deep-seated legacy of racism" and social inequality remains in Guatemala—even as a UN verification mission prepares to pull out in December.

Aid projects for shattered communities are numerous, but many are run by foreigners. Few are like the one in Momostenango, a mountainous district inhabited by 120,000 mainly Quiché Mayans. Spearheaded by a Mayan holy man, known as don Abraham, and a local doctor, Lionel López, it takes a holistic approach, combining mental-health counselling, medical care, social work and development assistance (such as advice on agricultural techniques). Unusually, in a country known for its racism, the *ladino* professionals who travel in from the city—a medical doctor, psychologist and social worker—defer to don Abraham, who is the go-between with village leaders, and to his insistence on using both western and traditional healing techniques, such as floating flowers and candles down the river to carry away bad luck.

Foreign support, primarily from a UN fund for torture victims and private donations, sustains the programme's meagre budget. The Marjorie Kovler Centre for the Treatment of Survivors of Torture in Chicago gives technical assistance and training. American medical students occasionally visit to help for a month or two. Cuban doctors come for two-year stints. Yet the need continues to exceed the resources.

And it remains a dangerous business, with perpetrators of war crimes still at large. Dr López has received death threats. The mental health clinic in the town of Momostenango is an anonymous storefront. Along the dirt roads that snake through the mountains, it is still common to see trees covered with political posters supporting Efraín Ríos Montt, the former dictator whose reign in 1982-83 was part of the war's bloodiest period.

Encouragingly, Óscar Berger, who roundly defeated General Ríos Montt in last year's presidential election, has started to make good on some of the empty promises of past administrations. This summer the government promised to pay 30m quetzales ($3.8m) a year for the next ten years to war victims as compensation. That, though meagre for an estimated 1.5m victims (and far less per victim than the sums promised to former PAC members), is more than ever promised before, and will be administered by a commission of indigenous groups.

The government has also cut the size of the army, and admitted the army's guilt in several important human-rights cases. Rigoberta Menchú, a Quiché woman and Nobel Peace Prize winner, and Victor Montejo, a Mayan writer who returned from exile last year, both have jobs in Mr Berger's administration, Mr Montejo as head of the newly created ministry of peace. But after years of neglect of the civil war's

victims, and with many of the perpetrators still in powerful positions, they have their work cut out.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Canadian hockey

On ice

Oct 14th 2004 | MONTREAL
From The Economist print edition

A salary dispute puts Canada's favourite sport in peril

FOR many Canadians, winter, and even autumn and spring, revolve around the sometimes graceful, sometimes brutish game of ice hockey. But for the millions who enjoy the sport from the comfort of their couches, this season will be spent flicking through other channels.

The owners of the 30 teams that make up the elite National Hockey League (NHL) have locked out the players as part of an effort to make them accept lower salaries. League matches were supposed to start on October 13th and continue uninterrupted well into May. Now, it is almost certain that that there will be no NHL matches before January. Many predict that the entire season will be scrapped, and much of the next as well.

Certainly, NHL players are paid well, even obscenely. They earned, on average, $1.8m last season—a far cry from 35 years ago, when the superstars made a few tens of thousands and many lesser players took summer jobs to make ends meet.

Fat pay packets for players have resulted in slim profits for owners, or none whatsoever. Almost two-thirds of the teams claimed to have lost money during the 2002-03 season; overall the league claims to have gone $273m in the hole, on total revenue of just under $2 billion.

To staunch their losses, the owners are insisting that the players accept a salary cap that will amount to between $32m and $35m per team, in a collective-bargaining agreement to replace one that expired a month ago. The players refuse. They have proposed a 5% across-the-board salary rollback, tighter limits on what rookies can be paid, and various forms of revenue-sharing between rich and poor clubs. A salary cap, they say, is against the spirit of the free market. Trevor Linden, the president of the NHL Players' Association, accused the league's commissioner, Gary Bettman, a New York lawyer without hockey in his blood, of “a strategy of confrontation and control”. More to the point, the players know that a firm salary cap would severely restrict the owners' ability to outbid each other for better players, which has led to the current inflated salaries.

Fans can usually be relied on to support players rather than owners in a dispute. This time, however, polls indicate that they are backing the billionaires over the millionaires by a wide margin. Most seem to feel that no one should complain about being paid $1 million or so per year to shoot a puck around a rink. They also know that the players' handsome salaries have a lot to do with the exorbitant ticket prices of $150 or more for the big games.

Moreover, salary caps seem to be the way professional sports in North America are heading: both the National Basketball Association and the National Football League have adopted them. In those leagues, players' salaries account for 58% and 64% of total revenues; in the NHL it is 75%, according to the league's own study.

To generate public support, many of the players that have not left to play in Europe are taking part in charity games in Quebec and other provinces. The owners, though, know that recruiting replacements—scabs on skates—might make them look like the big bad employers of yesteryear. A more creative solution might be to have four skaters a side instead of five. It would open up the game—more grace, less brutishness—and save money on salaries. But short of such a radical remedy, the lockout looks like being a long one. After all, neither the millionaires nor the billionaires will be short of cash anytime soon.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Afghanistan's election

Taliban? What Taliban?

Oct 14th 2004 | KANDAHAR
From The Economist print edition

AP

Afghanistan enjoys a surprisingly peaceful vote, despite battles to come

“AT LAST, we are human!” rejoiced an elderly Afghan woman, sheltering from a gritty gale as she waited to vote in Kandahar on October 9th. Her enthusiasm was understandable. The clouds of sand swirling across Afghanistan delivered little of the horror grimly predicted for the country's first presidential election. Three policemen were murdered in southern Uruzgan province, a Taliban stronghold. Two days later, a youth was killed in Kabul by a rocket. But most Afghans cast their ballots unimpeded by death threats. Their delight as they did so was thrilling, and turnout seemed generally high. Little is yet certain about an election that was hardly observed by foreign experts, except this: for the first time in Afghanistan's history, the country's next leader will be the people's choice.

No skulduggery looked able to prevent that outcome. In the absence of Taliban bombs, or obvious massive rigging, the 17 challengers to Hamid Karzai, Afghanistan's transitional leader, were reduced to griping about the quality of the indelible ink used to mark those who had voted. In many places, it turned out to be all too delible, whether because the ink was faulty or because the UN's swiftly-trained election officials were actually using the wrong ink. Given that many voters were known to have registered under false names several times, this glitch may have allowed them to vote several times as well. But as the ink showed a tendency to disappear in random places across the country, it was hard to tell which candidate's advantage it would serve.

A decision by Mr Karzai's opponents to boycott therefore looked like an obvious effort to discredit a vote that none of them was remotely able to win. Happily, few Afghans were taken in. On radio phone-ins and in market-places everywhere the boycotters were denounced.

Having misjudged the nation's mood, the main contenders were happy to be coaxed back onside. And America's energetic ambassador, Zalmay Khalilzad, who is known as “the Viceroy”, was happy to coax them. As journalists arrived at the office of Yunus Qanuni, Mr Karzai's main challenger, to be told of his decision to honour the vote, Mr Khalilzad's car was seen speeding away. Another notable challenger, Mohammad Mohaqiq, of the Hazara minority, made a similar climbdown while flanked by two American embassy staff. To save the necessary faces, the UN agreed to launch an inquiry into why its ink had disappeared, with its findings to be revealed before the vote count is completed in two or three weeks.

With fewer than 300 foreign observers to monitor the vote at over 21,000 polling stations, the conduct of

the election was otherwise difficult to judge. Pre-pubescent children were photographed proudly casting votes. Briefly-trained UN election officials were observed instructing illiterate peasants whom to vote for. Polling sites in the northern fief of Rashid Dostum, an ethnic Uzbek and presidential hopeful, were wallpapered with his campaign posters. In violent Helmand province, a local drug baron opened an impromptu polling station in his house.

Yet these flaws seemed unlikely to alter the outcome. According to an exit poll run by the International Republican Institute (IRI), Mr Karzai was on course to garner 47% more votes than his nearest challenger. It also found that 97% of Afghans—the election's true observers—did not expect irregularities to affect the result.

Such a margin of victory would easily give Mr Karzai the 50% vote he needs to avoid a run-off. But it is only one poll, and could very well be wrong. Mr Dostum and Mr Mohaqiq appeared to have mustered excellent turnouts from their communities, and can expect to win most of their vote. That could account for 25% of the total. If Mr Qanuni were then to win most of the ethnic Tajik vote, a second round might be inevitable.

Some western diplomats hope so. In a divided country, still barely governed from the centre, Mr Karzai would need a massive majority to gain the legitimacy he desires, and this could probably be provided only by a run-off vote. With a more slender majority, Mr Karzai might feel compelled to continue his unfortunate habit of accommodating Afghanistan's warlords, by offering key cabinet posts to his main challengers. The resultant cabinet would offer little prospect of the change that Afghans seek.

Mr Karzai's transitional cabinet, which was largely bequeathed to him by a grand council, or *loya jirga*, that followed the Taliban's demise, boasted 32 ministers. Of these, barely half a dozen seemed competent. Several others were charged with drug-smuggling and other crimes. Several kept private armies. By maintaining such friends, Mr Karzai perhaps prevented a return to ruinous civil war. But his government was little able to extend its rule into the provinces.

To do so now, with more muscular help from his western backers than they have so far supplied, Mr Karzai must first disarm the militias upon whom the drug lords depend. Of those questioned for the IRI's poll, 50% considered the disarming of local commanders to be the government's top priority. Only 11% considered developing the economy of greater importance.

More happily, Mr Karzai has a couple of weeks to reflect on the Taliban's surprising no-show at the poll. Shortly before the election, an American aid worker trying to teach Afghans their democratic rights was alarmed when three bearded members of the Taliban appeared in his classroom in south-eastern Ghazni province. At the time, he thought that they had come to kill him. Now, it seems possible they had come to learn how to vote.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD ASIA

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Japan

The taxman cometh

Oct 14th 2004 | TOKYO
From The Economist print edition

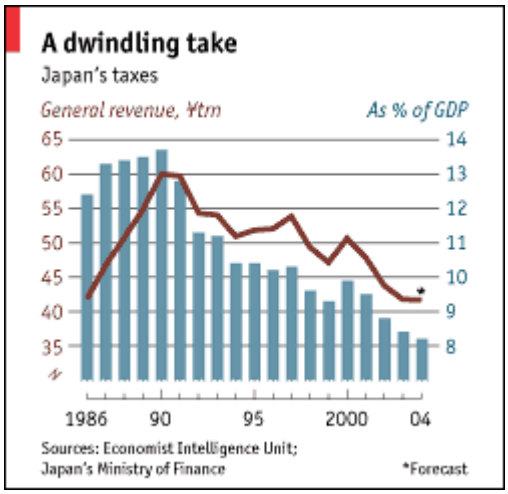
Can Japan fix its budget without cutting short its recovery?

Get article background

THEIR time is coming. The civil servants in Japan's Finance Ministry have watched nervously in recent years as the budget deficit has widened and government debt has risen sharply. Now that Japan's economy is growing again, the ministry is itching to raise taxes and close the gap. But many economists worry that Japan will repeat its mistake of 1997, when a rise in consumption taxes cut off a nascent economic upturn and plunged the economy back into recession. Can Japan get the timing right this time?

Its debt levels are clearly a worry. The most oft-cited measure, gross debt levels approaching 170% of GDP, overstates the problem, since it does not account for financial assets held by the government. But even so, Japan's net public debt has reached 80% of GDP, according to the International Monetary Fund, and is rising rapidly, despite the economic recovery. Moreover, the government's interest payments—now a lowly 1.5% for ten-year bonds—could rise sharply if prices eventually stop falling throughout the economy, something many economists believe could happen next year.

To tame the debt and reassure bond investors, the government has announced a medium-term plan to get deficits under control. It aims to cut the primary deficit, which excludes interest payments, to zero by 2010. But even that will be a tall order. The Finance Ministry expects to record a primary deficit of around ¥19 trillion ($173 billion), or 3.8% of GDP, in the year to March 31st.



Although Junichiro Koizumi, the prime minister, has been cutting Japan's mammoth public-works budget sharply, it will be hard to erase the deficit with spending cuts alone. Japan's greying population will drive up medical and pension payments. At some point, higher tax revenues will clearly be needed. In fact, revenues slid throughout the 1990s, and continued to collapse during a downturn that ended in 2002. Nominal tax revenues are now roughly where they were in 1986, before the 1990s boom inflated them, so taxes are much lower as a share of GDP (see chart).

The Finance Ministry argues that much of this has to do with tax cuts introduced during the 1990s, which on the whole have far outweighed the 1997 rise in sales tax. Personal cuts enacted in 1999 lowered income taxes. Corporate tax rates were also cut during the 1990s, and companies have recently been allowed to offset profits against losses across their numerous subsidiaries, reducing the burden further. The Finance Ministry's website features cartoon citizens who are amazed how much corporate and individual tax rates have been cut.

The government, which in December will begin working out a tax plan in earnest, will probably eliminate some of the personal income-tax cuts over the next couple of years. The impact is likely to be small, however, increasing revenues by only ¥1 trillion or so a year at first. The bigger questions are those surrounding local finances and sales taxes. Mr Koizumi has been backing a plan to grant local governments more autonomy. They will lose tax grants and subsidies, and in exchange will be allowed to keep about ¥3 trillion of the tax revenues raised in their towns and prefectures. Local governments fear, however, that the Finance Ministry is planning to use this as a way to shrink the central deficit at their expense.

Eventually, sales tax rates, currently at 5%, will have to go up to help offset the rising cost of social security. The timing, however, will be crucial. Mr Koizumi, who must step down by September 2006 because of his party's six-year term limit, has pledged not to enact sales-tax increases while he is in office. Most onlookers, however, expect the Finance Ministry to press for increases that kick in almost as soon as Mr Koizumi is gone. With luck, the government will be wise enough to phase these in gradually, and the central bank will offset any tax rises by keeping monetary policy loose. But with growth already starting to slow, all this tax talk is making people distinctly nervous.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Taiwan and China

Speaking across the strait

Oct 14th 2004 | TAIPEI
From The Economist print edition

Something old, something new

Get article background

AP

Can you hear me?

CHEN SHUI-BIAN, Taiwan's president, had said that his National Day address on October 10th would be an “important” overture to China. But although some of it did indeed appear conciliatory, much was not. As Taiwan gears up for yet another round of elections—this time for the legislature in December—neither the president nor the Chinese across the strait are in a mood for big concessions.

Mr Chen has many audiences to play to: an angry and anxious China that sees Taiwan drifting towards independence, ardent supporters of his pro-independence Democratic Progressive Party (DPP) who want nothing to do with the Chinese, others in Taiwan who fear a dangerous conflict is looming and foreign officials who worry that he is a maverick who could drag the United States into war. On the eve of Mr Chen's speech, President Jacques Chirac of France said during a visit to Beijing that tensions in the Taiwan strait were worsening. Any challenge to the balance (ie, moves by Mr Chen to assert formal independence) would be, he said, “very dangerous and detrimental to everyone”.

The Americans, at least, expressed approval of Mr Chen's speech, which called for a resumption of structured talks with China that have been suspended since 1999. Such appeals by Taiwan are nothing new. But Mr Chen suggested the talks could be held on the same terms as the two sides' first contact in 1992. Although he did not spell out what this meant, his offer could mark a subtle shift. The DPP has, at least until now, rejected the view, held by opposition parties and by China, that the 1992 talks were based on a “consensus” of the two parties on how to handle the hotly disputed concept of “one China”. According to this reported agreement, as the Taiwanese opposition sees it, they would both uphold the idea of “one China”, but would offer their own interpretations of what it meant.

Unfortunately for the optimists, Mr Chen did not refer to “one China”, nor even explicitly to any “consensus”. And his speech was peppered with references to the separateness and smallness of Taiwan. “In Taiwan—a country of 36,000 square kilometres with effective governance and a sound political system—sovereignty is vested with the people,” he said. To China, those are fighting words. It rejects the idea of the island as a country and likes to think that the Republic of China, as Taiwan officially calls itself, connotes some link with the vast mainland.

China has dismissed the speech as “provocative”. But it would not have wanted to give Mr Chen a boost before the polls on December 11th. These are crucial for Mr Chen, who won a second term of office in March by a tiny margin in elections that are still being contested by the opposition as unfair. He wants to strengthen his mandate and to end the domination of the legislature by opposition parties that want a more conciliatory approach to China. With a presidential election also coming up in America, Taiwan's chief backer, China is in wait-and-see mode.

Mr Chen's other suggestions—arms-control measures, a formal end to hostilities, an agreed “code of conduct” in the Taiwan strait—are simply non-starters. China has shown no sign of willingness to reduce its build-up of missiles and other arms on the coast facing Taiwan. And Mr Chen is not about to upset the Americans by abandoning plans to purchase $18 billion-worth of American weaponry. Mr Chen said his officials were working on ways to establish flights across the strait, but China swiftly spurned that idea—

repeating its insistence (unacceptable to Taiwan) that any such flights should be called “domestic”. Little goodwill there.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Sri Lanka's peace process

As good as it gets?

Oct 14th 2004 | COLOMBO
From The Economist print edition

"No peace, no war" may be better than the alternative

Get article background

FOR a year and a half, Sri Lanka's peace process has been locked in an ugly stalemate. In April 2003, the Liberation Tigers of Tamil Eelam, who had been waging a 20-year war for an independent Tamil homeland in the north and the east of the island, withdrew from talks with the government. Since then, a ceasefire agreed on a year earlier has held, despite violations. Norwegian diplomats, who helped arrange it, have expressed fears that the antagonists' "incredible complacency" masks a "melting at the edges" of the frozen war. But neither side seems to want to plunge into renewed conflict.

Not that the violence has stopped altogether. In particular, since this March, when a Tiger commander in the east known as Colonel Karuna rebelled against the leadership of Velupillai Prabhakaran, some 150 of his supporters have been murdered, presumably by mainstream Tigers. On October 11th, for example, two were shot dead in their beds in Nagastanna, in the east.

The formal disagreement with the government that is stopping talks concerns their scope. The Tigers insist the talks must be based on their proposal for an "Interim Self-Governing Authority" (ISGA). The government argues that "core issues" must also be discussed. The Tigers fear the government will block the interim authority, thwarting hopes that Tiger-controlled areas might start enjoying the massive foreign assistance promised to Sri Lanka in return for peace. The government fears the interim authority will pre-empt the final outcome, and turn into a new platform for a Tiger bid for full statehood.

These differences are more than semantic. But they do not seem unbridgeable. The true obstacles to talks lie in the two sides' internal troubles. Mr Prabhakaran swiftly swatted any military threat posed by Colonel Karuna. But the colonel's allegation of northern dominance of the Tigers struck a chord among Tamils in the east and uncovered a political danger.

Even more troublesome are disagreements between the two parties that make up the coalition government formed in the south after elections in April. The bigger, the People's Alliance of Chandrika Kumaratunga, the president, is willing to discuss the ISGA. Its partner, however, the Janatha Vimukthi Peramuna, appeals to the chauvinism of Sri Lanka's Sinhalese majority and opposes any concession by the government to the Tigers.

In an effort to forge a consensus about the peace process, Mrs Kumaratunga has formed an advisory council. But that has been boycotted both by the Tigers' representatives and by the main opposition United National Party (UNP), led by Ranil Wickremesinghe, prime minister until April. They suspect the council is nothing more than another tactic to delay talks.

The rivalry between Mrs Kumaratunga and Mr Wickremesinghe will intensify as the end of the president's term approaches. Remarkably, because of an arcane constitutional dispute, it is still not known whether this will be in December 2005 or a year later. The UNP will try to insist on the earlier date, and Mrs Kumaratunga may resume efforts to amend the constitution to abolish the executive presidency or, failing that, to give herself a third presidential term.

Both sides in Sri Lanka's civil war have enough on their plates without either negotiating peace or taking up arms again. The Norwegian-led ceasefire monitors, at any rate, see no sign of preparation for war. But the stalemate has a price: aid is trickling in, but the pot of gold expected a year ago is still at the end of the rainbow. The high price of oil helped widen Sri Lanka's trade deficit by 56% in the first seven months of this year compared with last. Official reserves of foreign exchange at the end of August were $2 billion, covering just three months' imports. Economic complacency may be even less justified than the political variety.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD ASIA

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Asia, Europe and Myanmar

Face-off

Oct 14th 2004
From The Economist print edition

A row that could run and run

WHEN half the world meets up for a chin-wag, little more than platitudes can usually be expected. Yet the two-yearly ASEM (Asia-Europe Meeting) summit in Vietnam that ended on October 9th was even shorter on real substance than it might have been. The assembled 38 governments (25 from the European Union and ten from the Association of South-East Asian Nations, ASEAN, plus China, Japan and South Korea) said all the expected things about encouraging trade, protecting the environment, fighting terrorism and crime, and ridding the Korean peninsula of nuclear weapons. But they could not manage a proper public rebuke (some harder words were spoken in private) of the military dictatorship in Myanmar for stifling dissent and keeping Aung San Suu Kyi, the leader of the country's democracy movement, under house arrest.

ASEM has said harsher things in the past about the Myanmar regime's nasty little ways. This time, however, under a deal to save the summit series from complete collapse, Myanmar was at the table (along with two other new ASEAN recruits and ten newcomers to the EU), albeit represented by its labour minister, not its boss.

Some European governments, particularly Britain's, had wanted Myanmar kept out of ASEM altogether. But the compromise was not just that Myanmar would lose face over who was invited; it was also supposed to take steps towards democracy and release Miss Suu Kyi. Since none of this had happened, on October 11th the EU's foreign ministers tightened sanctions: a visa ban on regime stalwarts will now extend to senior members of the armed forces and their families; the EU will oppose lending by international financial institutions; and EU-registered companies and organisations will be barred from financing state-owned companies with close ties to the military regime.

Such sanctions can have only modest effect. While the generals and their families may fume about being unable to send their offspring to schools and universities in Europe, most European companies, with government encouragement, already shun the place—with the exception of Total, a large French oil company. Nonetheless, the regime had been sufficiently livid at its lowly representation at the summit that it fired its civilian foreign minister, and replaced him with a general.

Yet it is Myanmar's neighbours, and especially China, that can wield the greatest influence. They prefer dialogue to confrontation. But they too seem to be losing patience with the generals' repeatedly broken promises to release Miss Suu Kyi. Nor will outside pressure let up. In 2006 Myanmar is due to chair ASEAN and host its widely attended Regional Forum. Without democratic changes, America, for one, has already said it will not show up.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD ASIA

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

North Korea

To Pyongyang with love

Oct 14th 2004 | PYONGYANG
From The Economist print edition

Foreign films and magazines hit town

NORTH KOREA'S leader, Kim Jong Il, is sometimes said to have preferred his earlier career, as a film director, to his present one of dictator. And an enthusiam for celluloid is a refreshing feature of the dour people over whom he presides. It was much in evidence last month, during the Ninth Pyongyang Film Festival. Perhaps that was because the festival has abandoned its traditional concentration on films from friendly and non-aligned countries—which in practice meant days full of film-makers from Iran, Syria and Vietnam all chatting about their latest revolutionary guerrilla videos. This year, the festival billed itself as "international", and even without glamorous cocktail parties or starlets—in Pyongyang, the last screening is at 6pm, and official banquets end at 9pm—it provided a rare chance for North Koreans to get a glimpse of the outside world.

North Korea used to produce dozens of films of its own, for release in fraternal communist states. Nowadays, though Kim Jong Il's famous book "The Art of Cinema" is still a bestseller, television seems to be taking over. But the North Koreans seemingly remain as keen on film as ever. The festival screenings were all packed out, with some workers even getting a day off to attend.

The selection at this year's festival was surprisingly open as well. Topics such as homosexuality and the loneliness of the elderly were featured, not swept under the carpet. A retrospective of a German film-maker, Margarethe von Trotta, Indonesian sitcoms, Austrian documentaries, Hong Kong action movies and "Bend It Like Beckham", a multi-racial British comedy, were all on show. True, the final prize list sounded like a roll call of the axis of evil and its associates (first China, then Iran and Syria) but the five members of the international jury said they had made their choices without duress, and were impressed by the quality of this year's selection.

Another special guest at the festival was the head of the German delegation, Uwe Schmelter. Usually in charge of the Goethe Institute in Seoul, he was responsible for an impressive showing of German films and documentaries, and even brought along a famous German actress. He is well known in the north for having presided over the opening in June of Pyongyang's own Goethe Institute, the first foreign cultural centre in North Korea. It offers some 8,000 books, CDs, videos and German newspapers and magazines—all freely available to any North Korean. It is a small indication that things are slowly starting to change.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Egypt and Israel

Bonded by bloodshed?

Oct 14th 2004 | CAIRO AND TEL AVIV
From The Economist print edition

Getty Images

A terrorist attack in Egypt against Israelis and Egyptians may nudge their two governments towards closer co-operation

IN THE minds of their plotters, last week's terror attacks on beach resorts in Egypt's Sinai peninsula were a great success, striking all their enemies at once. They killed Israelis, thereby avenging Palestinians killed by Israel's army, which has killed at least 99 Palestinians (many of them civilians) in the Gaza strip in the past fortnight, for the loss of three Israelis. The terrorists hit an American-run hotel, the Taba Hilton (pictured above), punishing the superpower responsible for warring against Islam. They shook Egypt, whose craven, secular regime consorts with the Zionist imperialist crusader enemy. Best yet, the attackers succeeded not only in penetrating tight security to plant their car bombs but also in escaping into the desert night.

The terror in Sinai, which wounded scores of innocents and killed 34, including at least 12 Israeli tourists and 9 Egyptians, looked similar to other strikes by al-Qaeda-affiliated cells, such as those in Istanbul, Casablanca, Riyadh and Mombasa. Like those attacks, the Sinai bombs were multiple, and directed at soft targets. But what was also similar is that the attacks seem to have won the *jihadis* anger from fellow Muslims rather than praise—and a larger number of enemies.

Take the Palestinians. After four years of the *intifada*, their bitter uprising, they may care little for Israeli suffering. Yet the realists among them know that attacks like those in Sinai blur the line between what Palestinians see as their own legitimate struggle for freedom and the *jihadis'* far more ambitious and more contentious campaign to purge the Muslim world of all alien influence. Such blurring, they know, enhances world sympathy not for the wretched Palestinians but for Israelis.

Moreover, the Sinai attacks had less impact than might have been expected in Israel, partly because the scale of casualties was less than first reported, partly because Israelis have grown used to such tragedies, and partly because the country is embroiled in a bruising political struggle over the proposal of its prime minister, Ariel Sharon, to pull troops and Jewish settlers out of Gaza. But the attacks did serve to reinforce Israelis' sense of physical isolation. Israelis have long favoured the coral-rich coast of Sinai as a get-away from Israel's own stress, and it attracts some 250,000 of them a year. Few will be going back soon.

Their departure is no comfort to ordinary Egyptians, whose otherwise listing economy has increasingly been kept afloat by booming tourism. Israelis account for only 5% of visitors but Egyptian tour operators,

who had been geared for another bumper winter season, are already reporting cancellations from other countries. Egypt has been free of terrorism since the 1997 massacre of tourists at Luxor, which provoked general revulsion against home-grown militants, hurt millions who live off the tourist trade, and prompted leaders of Egypt's main Islamist radical group to renounce violence for good.

It is true that Egyptian feelings for Israel have, despite 26 years of peace, hardened notably in response to relentless coverage of the Palestinian *intifada*. Many Egyptians shrugged off the Sinai attacks as an inevitable response to Israel's harsh suppression of the Palestinians. Cairo's shrill opposition press was quick to point an accusing finger at Israel's own intelligence services, whose purported aim was to wreck Egyptian tourism and stir global anger against Islam.

But for many Egyptians, the sight of their own people suffering alongside Israelis and then co-operating in the rescue effort awoke a new sense that Islamist terror is not just something that happens elsewhere. Among the Egyptian victims were ordinary hotel workers as well as prominent businessmen, including a long-standing chairman of Egypt's national airline, a former airforce general who was a close friend of President Hosni Mubarak.

The immediacy of the attacks' impact was also felt in an abrupt and drastic heightening of security across the country. Not only did this revive memories of tenser times in the early 1990s, when Egyptian police crushed a small-scale insurgency by Islamist radicals. It has dampened, for the moment, what had been rising hopes that Egypt's government would allow political reforms, including the abolition of decades-old emergency laws that allow for arbitrary arrest and imprisonment—and which have most often been wielded against Islamists.

The sight of their own people suffering alongside Israelis and then co-operating in the rescue effort awoke a new sense that Islamist terror is not just something that happens elsewhere

To the chagrin of the terrorists, the attacks are also likely to strengthen official ties between Egypt and the Jewish state. Egypt withdrew its ambassador to Israel to protest against Israeli tactics early in the *intifada*, and relations with Mr Sharon's tough government have stayed severely strained. In recent months, however, Egyptian pessimism over Palestine has given way to a more pragmatic approach. The government in Cairo has tried to corral bickering Palestinian factions, including the Islamists of Hamas and Islamic Jihad, into some kind of accommodation with Israel's plan to leave Gaza.

Egypt has also offered to take a hand itself in ensuring that Gaza stays quiet after Israel withdraws. Willingness to help police the turbulent strip has, however, been tempered by discomfort with the notion of “doing Israel's dirty work” in keeping the Palestinians down. Egypt also objected to Israel's insistence that Israeli forces should control Gaza's borders, airspace and coast, and maintain a right to “hot pursuit” of terrorist suspects hiding in Egypt.

The Sinai attacks may remove some of Egypt's squeamishness about co-operating more fully with Israel, and perhaps also steel its resolve to push for a more ambitious regional peace. In the wake of the attacks, Mr Mubarak reiterated, with renewed urgency, his long-standing view that terror cannot be defeated without resolving the political problems, such as Palestine, that feed it.

Israel's government anticipates some dividends. Mr Sharon told his cabinet colleagues, in the wake of the bombings, “not to criticise the Egyptians”. “With the right policy, the attack could lead to stronger relations, based on the common threat [of terrorism],” said a senior official. “We should do everything to advance the common interest.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Iraq

A chink amid the gloom

Oct 14th 2004 | BAGHDAD
From The Economist print edition

A deal with a turbulent Shia and talks with rebel Sunnis offer a chance of respite

Getty Images

Swapping bullet for ballot?

HUNDREDS of gun owners have been converging on police stations in Sadr City, the rebellious Shia slums of north-eastern Baghdad, to give up arms for cash. Some came with plastic bags of rocket-launchers, others with carloads of mortar rounds. But many others simply wanted to know the price they could get for their private arsenals. Still, for the militiamen of Muqtada al-Sadr's Mahdi Army even to consider selling off their weapons suggests they may not be bent on using them in the immediate future against American troops or Iraqi police or soldiers loyal to the interim government. Some militiamen admitted that they hated to surrender the arms—a badge of honour for many Iraqi families. But they said they had to obey Mr Sadr and turn themselves from a fighting militia into a peaceful political movement. If this actually happens, it will hugely buoy hopes that Iraq's government and its American backers can bring Iraq to a more-or-less credible election in January.

Still, it is easy to be cynical about the arms deal. To qualify to take part in the election, Mr Sadr's lot must divest itself of its militia—and arms. Yet even after he said he would dissolve his Mahdi Army, American troops claim to have uncovered arms caches in mosques loyal to the cleric. Some even fear that under the arms deal Mr Sadr's people may unload their broken machineguns and rusty rockets, then use the cash to stock up with newer weapons.

Iraqi officials, however, say they are not being fooled. At the weapons handing-in points, police checked the workings of AK-47s to ensure they were not duds. Iyad Allawi's interim government says it will conduct house-to-house searches to check no one has more than the one rifle each household is allowed for self-defence.

Moreover, Mr Sadr has some good reasons for swapping insurrection for politics. His fiery speeches ridiculing the interim government's legitimacy have all but dried up. American troops have driven peacefully into Sadr City to start working on infrastructure projects said to be worth $500m, whereas in previous weeks they would have had to fight their way in.

No less important, Grand Ayatollah Ali al-Sistani, the most influential of Iraq's Shia clerics, has in essence endorsed the election by telling people to register as voters when that process starts in November. Though Mr Sadr has sought to rival Mr Sistani in the past, he has recently made sure he sounds in tune with the far more senior cleric. And though Mr Sadr has blown hot and cold on whether to take part in an election, it is plain he has a lot of support, especially among the 1m-plus voters of Sadr City, and could win a stack of votes.

Even more hopefully, Mr Sadr's disarmament deal may have impressed Fallujah, Iraq's biggest town in Sunni rebel hands. Its representatives have been talking for several weeks to Iraqi government people; some of them have told the Iraqi media that they are negotiating with an eye to taking part in the election. One proposal under discussion envisages the Iraqi National Guard moving in to assert central-state control, while American troops stay out. The recent American-led recapture of Samarra, another rebellious Sunni town, gave an impetus to the Fallujah talks.

But plenty of stumbling points remain. The Fallujah leaders may insist that any Iraqi troops in their city come from the surrounding area, a formula that may lead to a repetition of the deployment in April of a

locally recruited “Fallujah protection brigade”, which promptly went over to the rebels. Besides, Fallujah hosts a number of extreme radicals, including foreign *jihadis*, who will probably keep on fighting and bombing, whatever anyone else says.

In any event, such hopeful deals will not end Iraq's anarchy overnight. Some Sadrist splinter groups have already rejected Mr Sadr's decision to stop fighting. Others have recently taken with increasing enthusiasm to kidnapping foreigners, such as an American photographer later freed thanks to the good offices of Mr Sadr's colleagues. That incident reflects the rising rate of kidnaps, both of foreigners and Iraqis, a practice highlighted by the abduction and beheading of a British engineer, Kenneth Bigley, and two American colleagues, and fostered by reports that Italy's government paid $1m for the earlier release of two female Italian aid workers.

A network of criminal and insurgent groups, such as Abu Musab al-Zarqawi's, which claims to have killed Mr Bigley, is now paying street gangs to abduct people, then pass them on to the zealots. For foreign and Iraqi troops alike, it is a frightening task, with the kidnapping business so lucrative and lethal, to enter zones recently under rebel control. But at least they are starting to do so. For Mr Allawi, the past fortnight has offered a spark of hope that his government is making headway.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Cameroon

Come back in six months

Oct 14th 2004 | BONABILE

Why a presidential election promises to change very little

AFP

Biya all and end all

“FREE mosquito nets for pregnant mothers” was one of Paul Biya's more attractive campaign slogans. Bednets are cheap, easy to use and prevent children from dying of malaria. This is the kind of promise that wins votes.

But Cameroon's 71-year-old president has a 22-year record of not delivering. On polling day, October 11th, Catherine Ngomil's baby son was covered in mosquito bites. She had never received a net. Even so, she doesn't like to complain. She can always buy medicines in the nearest town, she says, which is reachable by a churned mud road from Bonabile, the seaside village where she lives. A sign by the road promises that it will soon be upgraded, but Ms Ngomil is not counting on it.

The ballot boxes were transparent, and voters' rolls were posted outside polling stations. But Cameroonians found it hard to enthuse. The country was plastered with posters of a besuited Mr Biya walking at the head of a crowd of adoring followers, but it was an obvious sham. His photo had clearly been cut-and-pasted, and the crowd was a composite, with people walking and looking in odd directions.

Mr Biya is not loved, but thanks to a divided opposition, he looked sure to win another seven-year term. His opponents claimed, with justification, that his supporters were issued with multiple voting cards. But some foreign monitors said the poll seemed adequately fair.

Whether it was rigged or not, the main opposition parties hardly helped their cause by failing to unite. Veteran dissidents such as Adamou Ndam Njoya and John Fru Ndi, whom many Cameroonians think was cheated of victory in the presidential poll in 1992, could not agree which of them should be president.

The president's party is said to have added to the confusion by secretly backing spoiler candidates: 16 names were on the ballot. Mr Biya presents himself as the only man capable of preventing anarchy. Cameroon has hundreds of languages and ethnic groups. The opposition's disunity reflects this: Mr Ndam Njoya is a francophone Muslim northerner, while Mr Fru Ndi is an anglophone Christian westerner. Mr Biya is skilled at playing different groups and regions off against each other.

Cameroon is stable under his autocratic rule, but poor, in debt and directionless. It has oil, so Mr Biya can rely on a measure of western backing. Within days of the American-led attack on Iraq, he dined with President George Bush and heard Colin Powell, his secretary of state, promise that America would do everything it could to back Cameroon's government.

Apart from producing its own oil, Cameroon is also the route by which some landlocked countries can get their oil to the Atlantic. A new pipeline run by a consortium including ExxonMobil and ChevronTexaco already brings about 200,000 barrels of oil a day from Chad to a port in southern Cameroon. It could be used to shift oil from Niger and the Central African Republic too.

Despite the oil, most Cameroonians are still very poor. One in six dies before the age of five. Oil production is dipping, the country's debts amount to around 60% of GDP, and the government finds it hard to convince donors that it deserves debt relief because it is so astonishingly corrupt.

Three days before the election, your correspondent went to the finance ministry to find someone to

explain Cameroon's case for debt relief. It was almost deserted. An anti-corruption unit, behind a door marked “Inspector Number One”, was empty. Elsewhere, an official, asked about the president's plans to fight graft, paused and said: “Come back in six months.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Malaria

Biting back

Oct 15th 2004
From The Economist print edition

New hope in the battle against one of Africa's biggest scourges

WHILE AIDS grabs headlines, another infection quietly continues to devastate Africa: malaria. Every year it kills well over 1m people. While wider use of bednets can help prevent infection, and better access to newer drugs can treat it, an effective vaccine is still badly needed.

Good news, then, in the latest issue of the *Lancet*, a British medical journal. It reports promising results for a new malaria vaccine in clinical trials with just over 2,000 children aged one to four in Mozambique. The vaccine managed to reduce the risk of malaria in immunised children by 30% and cut cases of severe malaria by more than half. That is far from complete protection, but a big step forward in malaria vaccines and the best result of any tested so far, says Melinda Moree, head of the Malaria Vaccine Initiative, a not-for-profit group that co-ordinated and funded the trials conducted by researchers from GlaxoSmithKline (GSK), the world's second-largest drug company, the University of Barcelona and Mozambique's health ministry.

The next step is to test the vaccine in children under one: such babies are the most vulnerable to malaria. If it proves safe and effective for them, the jab could be part of the standard package of childhood vaccines in malarial countries by around 2010. GSK, which owns the vaccine, has said it will make it for the public sector. But this will be costly, and as the vaccine is not suitable for the more lucrative travellers' market, the company will need assurances that rich countries will buy it for poor ones. The world now spends $400m a year on fighting malaria in poor places—much of that from one donor alone, the Gates Foundation—compared with almost $5 billion on AIDS. More money and attention are still needed to take the sting out of malaria.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

South Africa

Grumbles about the new tycoons

Oct 14th 2004 | JOHANNESBURG
From The Economist print edition

Does black power benefit only the rich?

WHO IS fuelling the growing resentment against “black economic empowerment”, South Africa's policy of putting more wealth and jobs into black hands? Not big firms like the mining house Anglo American, which first unveiled plans to boost black ownership of capital a decade ago; they want friendly ties with politicians and would not dare challenge a sacred cow of government policy. Oddly, the most sceptical voices are being raised by prominent members of the ruling African National Congress, the party that has been keenest to champion the black-empowerment policy.

Most outspoken is Kgalema Motlanthe, the ANC's secretary-general. This month he complained that too few people benefit when big white firms hand over minority stakes to favoured black partners. “We see the same names mentioned over and again, in one deal after another,” he says. Standard Bank, for example, recently chose Saki Macozoma and Cyril Ramaphosa as partners in a deal supposed to boost black empowerment that netted each man around 200m rand ($30m).

Along with Patrice Motsepe, a gold tycoon, and Tokyo Sexwale, who is in banking and diamonds, the pair make up South Africa's leading quartet of black businessmen. Mr Macozoma suggests that there are not yet enough black businessmen among whom such opportunities can readily be spread, so the only “practical and effective instrument” to reduce white dominance of the economy fast is to move chunks of it into the hands of the few, like himself, who have the nous to make the most of it.

No, says Mr Motlanthe, who probably spoke out only after getting clearance from his boss, President Thabo Mbeki. In any event, his comments have helped air doubts about the wisdom of the government's efforts to boost black business. Other aspects of affirmative action are being queried too. In June, the defence minister, Mosiuoa Lekota, said that complicated race-based recruitment in the army and elsewhere must eventually end. “When will we cease to be Africans, Coloureds, Indians and whites and [become] merely South Africans?” he asked. In July, the deputy minister of finance, Jabu Moleketi, suggested in an internal ANC document that business policies seen to favour only black tycoons are putting off foreign investors.

In September, the finance minister, Trevor Manuel, was blunter still. He berated an audience of black accountants and businessmen, saying they had exploited pro-black policies to raise their salaries to 16 times the average black household income. “When people without adequate experience are placed into positions of power and influence simply because they possess the right qualification and are of the right race and gender, then the result is massive financial risk for the companies concerned and in some cases for the economy as a whole,” he said.

The new scepticism is partly due to political jockeying. Those vying to succeed Mr Mbeki as the ANC's leader, to be chosen at a congress in 2007, are happy to bash rich rivals, like Mr Ramaphosa and his gang of four. The ANC, which ditched socialism a decade or so ago, knows that poor voters resent the sudden wealth of a few black moguls. Moeletsi Mbeki, a businessman who is the president's brother, says that the image of rich black cronies is damaging the party and becoming a *kgo-kgo* (hidden monster, in Xhosa).

Critics on the left want South Africa's leaders to reconsider, if not abandon, free-market economics, citing the inequalities of black empowerment. Zwelinzima Vavi, head of the main trade-union body, is threatening to obstruct a deal in the finance industry worth 122 billion rand that is meant to bring more black partners into banks and insurance. He says it will help only “a narrow group of individuals... already rich through transactions of this type”; banks should use their cash to build houses for poor blacks, fund small black businesses and subsidise black farms.

Others want to scrap race-based policies altogether. Instead of arguing over how to share wealth, says Moeletsi Mbeki, business people of any colour should be encouraged to create more wealth and jobs. Many small-scale black businessmen are emerging. The *Financial Mail*, a weekly magazine, says that in the past three years an extra 300,000 black South Africans have become middle-income earners, making more than 6,400 rand a month. White firms and the government, it is being suggested, should seek small black partners, not just the gang of four tycoons or black swells like them.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Liberia

Presidential striker?

Oct 14th 2004
From The Economist print edition

A footballer could become Liberia's president

Reuters

The ultimate goal beckons

SOCCER provokes passion among Liberians. Fans were so upset recently when their national team lost 3-0 to Senegal that they went on the rampage. The game was held up in the second half for nearly half an hour as cans, stones and bottles rained down from the stands. Rioters looted the coach's house, two people were killed, and the head of police called for his own country to be banned from hosting games.

Yet in 15 years of almost unbroken civil war, soccer has provided almost the only glint of hope among the carnage. One man above all stood for that hope: George Weah, Liberia's World Footballer of the Year in 1995.

The only African to have won that award, Mr Weah has almost God-like status at home. He dipped into his deep pockets when the government could not afford to pay for its team to travel. He insisted it should visit schools to promote education and good behaviour. On the pitch, his match-winning talents helped unify the nation. “During the war, when there was an international game, the fighters laid down their weapons to come and watch,” says Liberia's minister of youth and sport, Wheatonia Dixon-Barnes. “That was because of George.”

Now a coalition of parties is trying to persuade him to run for president next year—and he has a fair chance of winning. “I'd vote for George,” says a hawker, “because he's a good man.”

None of the warlords and schemers who have run the country since Master-Sergeant Samuel Doe seized power in 1980 can be described as good. Yet Liberia's intellectuals fear that the same politicians who are hated by most Liberians, especially the young, might run rings round the big-hearted footballer.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Robert Guest

Oct 14th 2004

Robert Guest, our Africa editor, has won this year's Frédéric Bastiat prize for journalism that “promotes the institutions of a free society”, for his survey of Africa in *The Economist* on January 17th.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Italian government

Silvio Berlusconi's constitutional exercise

Oct 14th 2004 | ROME
From The Economist print edition

Devolution, or the consequences of changing the Italian constitution

MOST Italians do not want it. The opposition hates it. President Carlo Azeglio Ciampi and the governor of the Bank of Italy, Antonio Fazio, have both expressed concerns. The employers' leader has “many, many doubts”; union bosses have “grave misgivings”. What they are talking about is an overhaul of Italy's 56-year-old constitution that has become the legislative centrepiece of the second half of Silvio Berlusconi's government. It has also given the prime minister a more tranquil autumn than once seemed likely.

For over a month, Mr Berlusconi's followers have been voting through article after article of a bill to increase the clout of the prime minister and president at the expense of parliament, to change the way parliament makes laws and to confer new powers on Italy's 20 regions. Despite a row this week between the Northern League and the former neo-fascists, the National Alliance, patched up through the mediation of Mr Berlusconi, the bill was expected to clear Italy's lower house as *The Economist* went to press.

The right's unwonted unity on the constitution has, at least for now, spilled into other areas, notably the budget. Late last month, the cabinet approved plans by the new finance minister, Domenico Siniscalco, a former civil servant who joined the cabinet in July after infighting had seen off his predecessor, Giulio Tremonti. Mr Siniscalco aims to trim the projected budget deficit by €24 billion ($30 billion) to keep it below the euro area's precious ceiling of 3% of GDP. Almost €10 billion will come from curbs on public purchasing and current spending that are likely to put renewed strain on the coalition when the details go to parliament. Beyond that looms a bruising confrontation with the prime minister, who remains set on making early tax cuts of €6 billion, some of which his finance minister would like to defer.

A brief calm interlude

For now, though, constitutional reform has created an unnatural calm. It grew out of the demands of Umberto Bossi's Northern League, the most volatile and vociferous party in the coalition government. Surprisingly, it has since won the support of two other coalition parties, the National Alliance and the Christian Democratic Union of Centre Democrats. Both parties have largely southern electorates who fear that decentralisation will further enrich the already prosperous north. The credit for allaying such fears

goes to Roberto Calderoli, a Northern Leaguer who joined the cabinet last July, after Mr Bossi was incapacitated by heart problems. Once dismissed as a bombastic populist, Mr Calderoli has proved an adroit conciliator, yielding on key issues to reassure his allies.

There has long been pressure for constitutional reform in Italy. That its parliamentary chambers have equal powers makes it inordinately hard to legislate. Yet many constitutional experts fear that the government's cure will prove worse than the ailment. Giovanni Sartori, a former professor at Columbia University, foresees endless disputes between the lower Chamber of Deputies and a new federal Senate. Others have noted that, while future prime ministers would wield enhanced powers over the lower house, they would be almost powerless to impose their will on a recalcitrant upper house. That is one reason for believing that Italy's experiment with decentralisation could yet acquire a momentum that few but the Northern League would welcome.

Many constitutional experts fear that the government's cure will prove worse than the ailment

The bill hands the regions new powers over health, education and even policing, similar to those of some of Spain's autonomous regions. Nothing wrong with this idea in principle. What worries critics is the absence of any official cost estimate. It should be close to zero, as increases in regional spending ought to be balanced by reductions in the central budget. But this is Italy, where public employees can refuse to move indefinitely, forcing the authorities to hire anew. A study of a more limited exercise in devolution in 1997 concluded that central administration had actually expanded as a result.

The unions fret that devolution will undermine their ability to enforce national deals on pay and conditions. In Spain, salaries of publicly employed doctors, for example, vary widely between regions. This is, however, a good thing. In Italy, as in Spain, there are big regional discrepancies in recruitment problems and living costs.

From the other side, some critics fret that Mr Calderoli, in his quest for compromise, has watered down the bill so that it no longer delivers enough decentralisation. Health policy, for example, will continue to be decided nationally, but implemented regionally. But Spain's experience suggests that such misgivings are wrong, for it has seen endless competition among regions for extra powers. The Italian bill leaves plenty of loopholes. For example, it gives regional governments the power to make laws in “every other area not explicitly reserved” for parliament in Rome.

With the conservatives enjoying an outright majority in both houses, there is little chance of any significant amendments. Even so, the bill has some way to go. Constitutional reforms in Italy must be passed by both houses twice. If the centre-right were ousted before the end of Mr Berlusconi's term in 2006, the bill would probably not become law.

The opposition is pinning its hopes on a referendum that even Mr Calderoli agrees is needed to approve the changes. In a recent poll, only 38% of Italians said they wanted them. And that highlights another big difference with Spain. There, power was handed to the regions in the 1970s after widespread dissatisfaction with a state that had become over-centralised under Franco. In Italy, it is being done to satisfy the Northern League, a party that, at June's European elections, won the support of only 5% of Italy's voters.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Lithuanian elections

The voters strike back

Oct 14th 2004 | VILNIUS
From The Economist print edition

A dissatisfied electorate backs a populist with Russian connections

Get article background

YOU might expect Lithuanians to be happy with their lot. They have one of the fastest-growing economies in Europe and they joined the European Union and NATO this year. They have not been this secure as a nation since the 17th century. Yet, like other new EU members, they are dissatisfied with their government. In a first round of parliamentary elections on October 10th, they demoted the ruling centre-left coalition into second place behind a newly minted populist party, the Labour Party, which promised cheaper heating, higher wages and higher pensions. Labour won 28.5% of the votes, and will now wrangle for a place in a coalition government.

Pollsters say the voters turned to Labour because they felt poor and depressed, they feared the free-market economy and they saw the mainstream political parties (with some justification) as elitist and corrupt. Many still believe that living standards were higher 20 years ago, when Lithuania was one of the richest republics in the Soviet Union, and not, as now, one of the poorest countries in the European Union.

The outgoing prime minister, Algirdas Brazauskas, who is 72, says that he may lead his coalition of Social Democrats and Social Liberals into an alliance with Labour, but only if he can stay on as prime minister. A government of that stamp would have a safe majority in parliament, but Labour's inexperience and populist leanings could make it an awkward bedfellow. So could the widespread supposition that Labour's leader, Viktor Uspaskich, a businessman-turned-MP who made money importing gas from Russia in the 1990s, has Russia's approval. Russia is pushing hard to increase its clout in the Baltic countries, and thus its clout in the EU. Lithuania's previous president, Rolandas Paksas, was ousted in April over his alleged links to influence-peddling cronies apparently behoven to Russian crooks and spooks.

Lithuania's tricky electoral system—which Labour wants to change—leaves the final shape of the parliament in doubt. Half of the 141 seats are filled by proportional representation, half from single-mandate constituencies. Second-round run-offs are needed in constituencies where no candidate secured a first-round majority. The Labour Party may emerge with 35-40 seats; Mr Brazauskas's centre-left block with 30-35; the main conservative and liberal parties, Homeland Union and the Liberal and Centre Union (LCU), may have 30-35 between them. The rest will go to three small blocks, including one loyal to Mr Paksas.

If Mr Brazauskas cannot do a deal with Labour, he may try for a “rainbow” coalition with Homeland Union and the LCU. But some in his party worry that shutting Labour out of power would only increase its popularity. Better to take the risk of bringing Mr Uspaskich into government, they say, and let responsibility curb him there.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Belarus

Luka the bad

Oct 14th 2004 | MINSK
From The Economist print edition

The president is set to consolidate his hold on power in a sham referendum

Get article background

Flying the flag against Lukashenka

BELARUS is not a lucky country. A third of its people were killed in the second world war; many others died in Stalin's purges. The nuclear disaster at Chernobyl, in 1986, contaminated a fifth of the country. Since 1994, the 10m Belarussians have been governed by President Alexander Lukashenka. Should Mr Lukashenka win a referendum on October 17th to allow him to run for a third term in 2006, they may be stuck with him indefinitely.

Independence was disorienting for Belarus, which had always been dominated by its Russian neighbour, and was even quite prosperous in the late Soviet era. After Mr Lukashenka, formerly a collective-farm manager, won the first presidential election in 1994, he set about reversing history. He retained the old name of the KGB and pursued a policy of ever-closer union with Russia. He also halted economic reforms, propping up state-owned enterprises, setting targets for growth and rebuffing advice from the IMF.

In other countries Mr Lukashenka has often been regarded as an eccentric but innocuous buffoon. To many compatriots, he is less amusing. “Of course Lukashenka is not Stalin”, says Anatoly Lebedko of the United Civic Party, “but he is his ideological grandson.” The president's opponents risk their liberty, livelihood and limbs, if not lives. Pro-democracy students have been expelled from universities and beaten up by the police. Mr Lebedko and other prominent politicians have been assaulted, and sometimes imprisoned. Human-rights groups are harassed by tax inspectors. In 1999-2000, three opposition figures and a journalist “disappeared” (“a tragedy”, says Ural Latypov, head of the presidential administration).

State-run television shows Mr Lukashenka exhorting ministers to realise his vision, and occasionally firing them for failing. That helps explain why he remains popular in poor villages and among the elderly. To be fair, pensions and state salaries are paid punctually, the economy is growing and inflation is relatively low. The president has vowed that average monthly wages will reach $195 by the end of the year. Even so, independent pollsters say he is not popular enough to win the votes he needs in the referendum.

Happily for him, in Belarus the counting matters more than the voting. Vintsuk Viachorka, of the opposition Belarussian Popular Front, has predicted “giant fraud on a nationwide scale”. After a referendum in 1996, Mr Lukashenka marginalised the country's parliament; but he is taking few chances with the parliamentary elections also being held on October 17th. Opposition candidates have been excluded from the ballots on what international election observers term “manifestly trivial or formalistic grounds”.

Mr Latypov says that, even if he wins, Mr Lukashenka may decide not to run for a third term. His critics hope that dissatisfied Belarussians will realise their own strength, or that the fractious opposition will unite. Pessimists predict redoubled repression after a referendum “victory”.

What can the rest of the world do? America's Congress has passed a Belarus Democracy Act, and is denying visas to officials implicated in “disappearances”, as is the EU. But such denunciations enable Mr Lukashenka to talk of a western vendetta. Mr Latypov says they are partly motivated by western disappointment at the success of the Belarussian economic model. They are also, he says, an indirect

attack on Russia. Moves for closer union with Russia dissipated when Mr Lukashenka realised he might be a mere provincial governor. But Moscow still sees him as useful, however buffoonish and nasty.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Germany's opposition

Doing their best to lose?

Oct 14th 2004 | BERLIN
From The Economist print edition

Angela Merkel v Edmund Stoiber

Reuters

“THE world's most idiotic right wing.” Traditionally, the label belonged to France's conservative parties. Now, it may be more apt for Germany. Angela Merkel, leader of the Christian Democrats (CDU), and Edmund Stoiber, Bavaria's premier and boss of the Christian Social Union (CSU), are locked in a wrestling-match that may cost the centre-right important state elections next year and maybe even the general election in 2006. Partly because of the infighting, Friedrich Merz, the CDU's economic guru, announced this week that he would resign from his positions in the party hierarchy.

At first blush, the fight is a power struggle over who should be the opposition's candidate for chancellor. Ms Merkel had managed, over the past 12 months, to outmanoeuvre her rivals. But since the CDU's dismal showing at state elections in Brandenburg and Saxony last month, her opponents have returned with a vengeance—particularly Mr Stoiber, who wants a second chance after losing to Chancellor Gerhard Schröder in 2002. Mr Stoiber is said to have called Ms Merkel and Guido Westerwelle, leader of the Free Democrats (FDP), “deckhands” who cannot hold a candle to Mr Schröder and Joschka Fischer, Germany's (Green) foreign minister.

Yet the fight is not only about the candidacy. It is also about strategy for the 2006 election, how best to reform Germany's welfare state and even whether the CDU can remain a broad people's party. In a way, Ms Merkel is in the same position as Mr Schröder in early 2003, when he launched his Agenda 2010 reforms. She must persuade her party, and even more the CSU, to accept far-reaching reforms.

A year ago, Ms Merkel seemed to have done this. In December, a CDU party congress overwhelmingly backed her plans to simplify Germany's income-tax system and overhaul the statutory health insurers. The CDU followed up with plans to scrap Germany's strict job-protection laws and give employers the right to opt out of national wage agreements. Going beyond Agenda 2010, Ms Merkel reckoned, was necessary to sharpen her own profile and to offer a clear-cut alternative to Mr Schröder's reforms. But she underestimated the internal resistance. The CDU's left wing is up in arms over job protection. And the CSU strongly opposes her pet project, which she cannot abandon without losing political credibility: replacing today's health-care contributions, essentially a tax on labour, with flat-rate premiums enhanced by tax-financed subsidies for children and the poor.

Her opponent on health is not Mr Stoiber, but Horst Seehofer, another CSU politician. To this former federal health minister, flat-rate premiums are not merely a hard sell, but also socially unjust. Proposing that a senior executive pay the same as his secretary for health insurance is, he argues, a recipe for

electoral defeat. Germany's budget deficits preclude using much public money for redistribution.

It will be hard to reach a compromise before the next CDU party congress in December, which Ms Merkel had hoped to be her “coronation mass”. Worse, Mr Stoiber seems in no hurry. When the CDU floated numbers to show that health-care finance plans discussed by the CSU would be more regressive still, he said he would not allow subsidies to be financed by higher taxes. Some observers think Mr Stoiber's goal is to weaken Mr Merkel so much that he could lead the opposition into coalition with the Social Democrats in 2006.

Others worry that the opposition may fall apart. Ms Merkel and Mr Stoiber are trying to counter such fears by changing the subject. On October 11th, both supported a plan for a petition against Turkey's EU membership. But if their quarrel persists, their parties could yet pick another candidate, such as Christian Wulff, the premier of Lower Saxony. When two people are disputing, goes a German saying, a third person will always enjoy it.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Macedonia

On the edge

Oct 14th 2004 | SKOPJE
From The Economist print edition

A vote on municipal boundaries threatens to reopen old conflicts

Get article background

COULD Macedonia go back to war? Watching Skopje's people sunning themselves as they wander around the market, it seems hard to believe. Harder still, when the *casus belli* turns out to be a referendum called for November 7th by opponents of a plan to redraw municipal boundaries. Yet the vote could upset the fragile peace deal signed in Ohrid that ended Macedonia's brief conflict in 2001.

Foreign dignitaries, fearful of once again being late to head off a new Balkan war, are issuing dire warnings. Two weeks ago Romano Prodi, the outgoing president of the European Commission, visited to present some 3,000 questions on Macedonia's bid for EU membership, and made his displeasure over the referendum clear. Michael Sahlin, an EU special envoy, calls the poll “a step away from EU membership”. Marc Grossman, an American under-secretary of State, has warned the Macedonians that, if it succeeds, the referendum will threaten their hopes of joining NATO in 2007. This week Donald Rumsfeld, the American defence secretary, called by to sing from the same song-sheet.

Saso Ordanoski, a local analyst, chortles that, with all this high-profile foreign pressure, “our nationalists are out of work.” The polls suggest that, with less than a month to go, a majority will indeed reject the government's municipal-boundaries plan. If this happens, Hari Kostov, the prime minister, says that the government will resign. That will mean total chaos, says Mr Ordanoski. But war? “No”, promises Ermira Mehmeti, spokeswoman of the government's leading ethnic-Albanian party. Her boss, an ex-guerrilla leader, Ali Ahmeti, also says that he does not expect to have to pick up a gun again. But he adds menacingly that he could not remain “indifferent” if the referendum put the Ohrid peace deal in question.

Macedonia, with its stagnant economy and high unemployment, sometimes feels like the bits left over after the other Yugoslavs went their own way. It has barely 2m citizens, 62% of them Macedonians and a quarter ethnic Albanians. The two peoples hate each other rather less than Albanians and Serbs do in neighbouring Kosovo, but they don't much like each other either. In Albanian villages, you never see a Macedonian flag, only Albanian ones.

Part of the Ohrid deal to end the conflict between Mr Ahmeti's guerrillas and the Macedonian state was a promise to decentralise the country and cut the vast number (123) of municipalities, many of them too small to function effectively. The problem, say critics, is that the deal on new boundaries was a gerrymandered one done behind closed doors between the two main ruling parties, the Macedonian Social Democrats and Mr Ahmeti's party. Biljana Vankovska, a political scientist, says this created the perception that Macedonian and ethnic-Albanian leaders are bargaining over the fates of towns and peoples “like feudal lords”. Macedonian anger at the Albanians, who seem to them always to get their way, combined with economic frustration to trigger successful demands for the November 7th referendum.

Dark rumours are circulating that new paramilitaries are forming, though there is no proof of this. Many Macedonians fear that the new boundaries will prepare the way for an ethnic partition of the country.

This is not obvious from the map. But such places as Struga, which now has a slight Macedonian majority, would acquire an Albanian one. If the referendum fails to stop this, threatens Struga's mayor, the city will declare independence “like San Marino or Monaco”. Macedonians are leaving areas inhabited by Albanians, and vice versa. Those who can are emigrating, with New Zealand the destination of choice. Macedonia may not go back to war after the referendum, but if the country plunges into political turmoil, it will set back hopes of its becoming more prosperous.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Kosovo

Status quo?

Oct 14th 2004 | BELGRADE
From The Economist print edition

An election that will matter for next year's talks on Kosovo's future

THE people of Kosovo are gearing up to vote. Although this has been a UN protectorate since the end of Serbian rule in 1999, some powers have been devolved back to elected politicians. The province's October 23rd poll matters because talks are likely to begin next year on its final status. More than 90% of its population is ethnic Albanian. Overwhelmingly, they want nothing less than full independence.

Nothing spectacular is expected to change on the Albanian side as a result of the elections. But who might the Albanians talk to, first in Kosovo's parliament and then in the final-status negotiations themselves? After the attacks on Serbs and other minorities last March by Albanian extremists, Vojislav Kostunica, Serbia's prime minister, his government and the Patriarch of the Serbian Orthodox Church all called on Kosovo Serbs to boycott the October 23rd poll. But Boris Tadic, Serbia's president, has called on them to vote. The Serbs have ten constitutionally guaranteed seats in Kosovo's parliament, but these deputies will have little credibility if the turnout is low.

Mr Kostunica is pushing a plan drawn up by his aides to create autonomous Serbian enclaves in Kosovo. The plan also suggests that some of the 220,000 Kosovo Serbs now displaced in Serbia should return to Kosovo, to live in new towns that link to areas where Serbs live now. But this echo of Israel's settlements in the West Bank seems unlikely to come about. One reason, suggests a report by the European Stability Initiative, a Berlin-based think-tank, is that there are not 220,000 displaced people in Serbia. Their research points to only 65,000, many of whom have sold their properties and have no intention of returning. The ESI also suggests that more Serbs remain in Kosovo than was thought. By examining school registers, the researchers calculate that there are 128,000 Serbs in the province.

Many Serbs think that Kosovo should be partitioned, with the mostly Serb-inhabited north joining Serbia. They argue that most Kosovo Serbs live there, so few would lose their homes by such a division. But this is wrong, says the ESI report. Two-thirds of Serbs actually live in the south, in rural areas. And most do not live in neat enclaves that could easily become Serbian autonomous areas. Similar research is now needed on how many Albanians live in Kosovo, a figure that varies between 1.5m and 2.2m. Without reliable data it is hard to make plans for health and education, let alone for elections or for an independent state.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Charlemagne

The let's pretend parliament

Oct 14th 2004
From The Economist print edition

The trouble with confirmation hearings for commissioners

FOR the past few weeks, the European Parliament has played an intoxicating game of “let's pretend”. Let's pretend that the European Union is the United States, the European Commission is the White House and the European Parliament is Congress. The opportunity has come in the confirmation hearings for new European commissioners, who are due to take office next month. But there are key differences between such hearings in Brussels and in Washington. Commissioners do relatively dull things like blocking mergers, or fiddling with fish quotas, rather than waging wars or running up trillion-dollar deficits. The powers of their inquisitors are also limited. Senate committees often block presidential appointments, but MEPs have no power to veto individual commissioners. All they have is a nuclear option: the power to reject the commission in its entirety.

Yet MEPs have been successfully testing the limits of their powers. They do not have the formal power to reject a nominee for president of the commission, but the European People's Party (EPP), which is the largest group in the parliament, made clear in June that it would create a huge row if Europe's leaders failed to nominate a commission president from the centre-right. The threat worked, and European national leaders duly named an EPP-approved candidate: José Manuel Barroso of Portugal.

After this little victory, it was predictable that MEPs would seek to demonstrate their power again by picking a fight over at least one of Mr Barroso's team of 24 commissioners. But who would be the fall guy? Some thought it might be Neelie Kroes, a Dutch businesswoman chosen to be competition commissioner, who was widely accused of conflicts of interest. Other possible victims included Peter Mandelson, a Briton nominated as trade commissioner, who twice had to resign from the Blair government, or Mariann Fischer Boel, a Dane nominated to the agriculture portfolio, who was felt to be too close to her industry.

In the event, the victim was Rocco Buttiglione, an Italian nominated to the justice and home affairs portfolio. His mistake was to move beyond technical responses and bland statements about his desire to promote the European ideal. Instead Mr Buttiglione, a philosopher and devout Catholic who has written papal encyclicals, was drawn on to the tricky ground of personal morality. He outraged feminists by appearing to suggest that a woman's role was to stay at home and raise children. Worse, Mr Buttiglione said he considered homosexuality a sin.

Although he quite properly drew a distinction between a sin and a crime, and added that the state had no right to stick its nose into this area, it was enough to outrage some MEPs. The “gay marriage” debate is very much alive; Spain will soon be the third EU country to legalise gay marriage. Marriage laws are a matter for member countries. But some MEPs detected a relevance to Mr Buttiglione's duties, since he will be in charge of EU laws on free movement of people, which could be stretched to cover gay partnerships. He might also have a role in anti-discrimination laws.

Mr Buttiglione had other strikes against him. He was nominated by Silvio Berlusconi, a hate-figure in the European Parliament, particularly on the left, ever since he likened a leading German Social Democrat (now leader of the Socialist group) to a concentration-camp guard. The Italian government is engaged in a crackdown on illegal migrants that some see as a violation of the European asylum laws which Mr Buttiglione is meant to uphold. And then there is the poisonous state of Italian politics. The committee hearings quickly degenerated into an intra-Italian slanging match. But the upshot was that his nomination was narrowly rejected in a vote by the parliament's civil-liberties committee. Moreover, now that the left is perceived to have turned down Mr Buttiglione, the right is threatening to veto the Hungarian Socialist nominated as energy commissioner, Laszlo Kovacs, who was deemed to have given an undistinguished performance in his confirmation hearings.

Da capo

This situation creates a big headache for Mr Barroso. In theory, the commission president could simply ignore the parliament and confirm both commissioners in their jobs. But that could tempt hot-headed MEPs to go for the nuclear option and reject the entire commission. The parliament has already forced the resignation of one commission, after a corruption scandal in 1999. It would surely be wise to shrink from staging a repeat performance before the new commission has actually taken office. But even if Mr Barroso successfully forces through the Buttiglione nomination, he would still have the problem that the justice portfolio, one of the most sensitive and rapidly expanding jobs in the commission, would be in the hands of a man who seemed to be damaged goods.

The easiest solution, from Mr Barroso's point of view, would be for Italy to withdraw Mr Buttiglione's nomination, and present another candidate. But Mr Berlusconi is unlikely to do this, for reasons of both principle and *amour propre*. That leaves Mr Barroso having to negotiate a tricky compromise over the course of the next two weeks.

As the new commission president ponders this, his first crisis, he faces a broader philosophical question: where should power really lie in the European Union? Conservatives argue that ultimately the EU is an organisation of nation-states. Federalists want to see more power move to supranational institutions, and above all to the European Parliament. For both political and ideological reasons, Romano Prodi, Mr Barroso's predecessor, did his best to cultivate the parliament. But, partly as a result, Mr Prodi's relationships with national governments deteriorated—and the commission suffered a damaging loss of authority. It is a lesson that Mr Barroso would do well to heed. The success or failure of his commission is ultimately more likely to be determined in Berlin, London, Paris and Rome than in Strasbourg.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Correction: Dutch GDP

Oct 14th 2004
From The Economist print edition

Last week's chart comparing growth of Dutch and euro-area GDP used nominal, not real, figures. In real terms Dutch GDP shrank in 2003.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

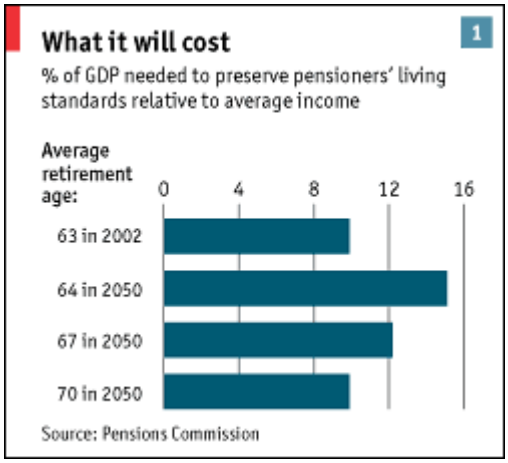
About sponsorship

Pensions

Harsh choices

Oct 14th 2004
From The Economist print edition

A major shake-up in British pensions is coming—but not until after the election



DENIAL is government's first response when pensions policy goes wrong. The Labour government has been no exception to this rule. But a landmark report this week from the government-appointed Pensions Commission has made denial impossible. Labour will put off difficult decisions until after the election expected in May next year. But a third-term Labour government will have to undertake painful reforms.

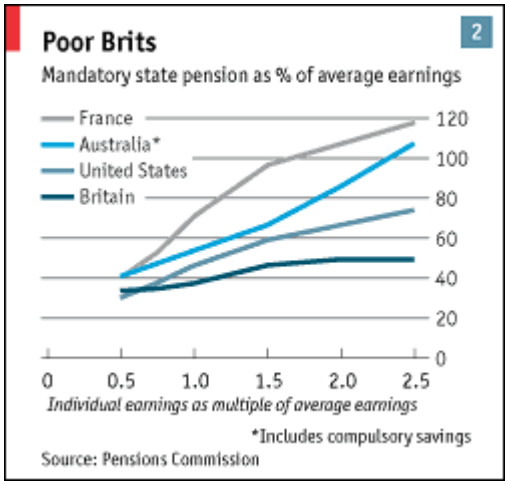
The report sets out inescapable choices that must be made as Britain, like other developed countries, confronts a rapidly ageing population. At present, 10% of GDP is transferred to pensioners. This will have to rise (see chart 1) by 2050 to 15% if future pensioners are to enjoy the same living standards in relation to average income; if it stays at 10%, their relative living standards will drop by a third. If the state funds the whole increase, it will need higher taxes equivalent to £57 billion ($102 billion) in today's money. The alternatives are a dramatic increase in income from funded pensions, or else the average retirement age—when people quit work, not when they become entitled to state pensions—must rise from 63 to 70.

The commission expects that income from funded pensions to people over 65 will rise by around 1% of GDP by 2050. And the government has already conceded the need for some increase in state spending on pensioners. Including housing-related and disability benefits as well as pensions and the pension credit, this will rise from 6.1% of GDP today to 6.9% in 2050. But even with these assumptions, which include a tax rise of nearly 1% of GDP, there remains a gap of 3% of GDP. A failure to plug it would leave pensioners' relative living standards 21% lower in 2050 than today. Alternatively, the average retirement age will have to rise to 67.

But serious difficulties will emerge long before 2050. Between 2010 and 2020, some help will come from the rise in the women's state pension age from 60 to 65, the same as for men now. The commission expects this will raise the average age of retirement for women from 61.6 to 63.8, the current male average. But Adair Turner, the commission's chairman, gave warning when presenting its report on October 12th that “the big problem” on current trends and policies will emerge in the 2020s. That is when there will be especially big increases in the number of pensioners, reflecting high birth rates in the late 1950s and early 1960s.

This demographic challenge should come as no real surprise, even allowing for unexpectedly rapid increases in longevity. Until recently, Britain's distinctive approach to pensions—a partnership between the state and the private sector—was expected to deal with this change more effectively than most other developed countries. This partnership, mainly with private employers, allows the state to provide no more than a basic income for pensioners, representing a much smaller proportion of average earnings for most retired people than in America or European countries like France (see chart 2). Altogether, state benefits account for about 60% of pensioner income, with the remaining 40% coming from private provision.

The Labour government was so confident that this system was working that in 1998 it declared its ambition to switch these shares by 2050 to 40% from the state and 60% from private provision. Its plan has been to concentrate state benefits more on lower earners, leaving everyone else even more reliant on private provision. However, the commission says that the state's share will stay at 60%, because the private sector is in a mess. Rather than expanding to fill the gap left by the state, the report says, “Britain's funded private pension system is in serious decline.”



The biggest setback has been in private defined-benefit schemes, which pay pensions linked to years of service and final salaries. Employers have responded to falling stockmarkets and ballooning pension liabilities by closing these schemes to new members. The decline has been startling. In 1995, there were 5m people in open private-sector schemes, now there are only 2m. Instead, new employees join defined-contribution schemes, which are much less generously funded. The commission estimates that the impact of this shift alone will result in a decline in private-pension saving of 1% of GDP.

As private employers reduce their commitment to funding pensions, individuals should do more for themselves. But the take-up of low-charge “stakeholder” pensions has been disappointing. And the government's means-tested pension credit, designed to help today's pensioners, makes saving for many workers on moderate incomes a foolish idea. Through the withdrawal of the pension credit for every extra pound of savings income they can incur marginal tax rates of at least 40%. “The long-term effect of the pension credit will be very damaging to incentives to save,” says Mark Pearson, head of social policy at the OECD.

So the state is providing less for most workers and the private sector is failing to pick up the slack. The result will be inadequate pensions for many people. The commission estimates that 9.6m workers aged over 35—that is 60% of all those in work over that age—are not saving enough. Of those aged over 25 some 12m are under-saving. Those affected are not just the usual categories like part-timers and the self-employed. The deterioration in private pension savings is hurting the retirement prospects of middle-income earners—“the same group most affected by the planned reduction in the generosity of state pension provision”, according to the report.

The fears of middle England about retirement security make pensions a politically charged issue. Yet big changes must happen. The commission lays out three ways forward. One is to reinvigorate the present system, which will require radical rather than incremental changes. A second is to rebuild the state pension, which will be very expensive. A third is to introduce a large-scale compulsory saving programme for workers, following a path blazed by Australia in the 1990s.

In an ideal world, that would frame a debate about pension policy in the upcoming election campaign. But the government will wait for the commission's recommendations, due in a year's time. The opposition parties favour rebuilding the state pension—in effect passing the cost of Britain's ageing population on to tomorrow's taxpayers. Compulsory saving, by contrast, loads the cost on to today's workers, in effect with an extra tax. No political party wants to be the first to say that the state pension age must rise, even though this is the surest way of making all the sums add up.

This is ominous. Constant changes have bred complexity, confusion and apathy. As Mr Pearson says, “no one who is more than 15 years away from retirement can have any confidence in what the state is going to provide.” Mr Turner's report has already been compared with that of William Beveridge in 1942, the founding charter of the post-war welfare state. But to put pensions on a more solid footing, the report will require politicians who rise to the challenge that it sets for the 21st century.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Guns in Nottingham

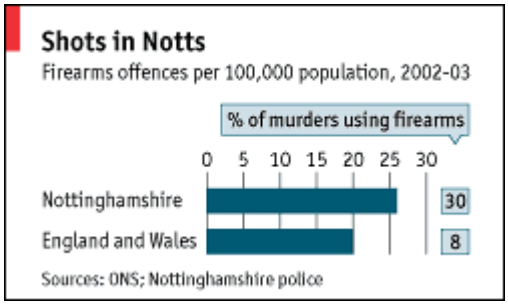
Disorganised crime

Oct 14th 2004 | ST ANN'S, NOTTINGHAM
From The Economist print edition

Nottingham's organised criminals have been eclipsed by freelance thugs

A PHOTOGRAPHER sprawls on the pavement, snapping a teenage girl in a pink velour tracksuit while she cups her hand around a candle flame to protect it from the October drizzle. Flowers and candles mark the spot where 14-year-old Danielle Beccan was shot dead early on Saturday morning as she returned from a funfair. First reports gave the shooting a gangsterish air: the bullets, they said, came from a gold Mercedes with blacked-out windows. The car has since been downgraded to a plain Citroen, which seems a more appropriate ride for the kind of low-rent but violent criminals who have given Nottingham a reputation as Britain's gun capital.

Jon Collins, the council's leader, says this is undeserved. The local police district accounted for under 3% of firearms offences in England and Wales last year, far less than London, Manchester or Birmingham. But Nottingham's record on fatal shootings is scarier (see chart). Across the country, 8% of murders are committed with a gun. Nottingham's police say that around 30% of their 34 murders in the past two years have involved guns—more than anywhere else in Britain, according to Sue Fish, the assistant chief constable. Most of the victims do not appear to have any criminal ties. Janice Collins, whose 16-year-old son was killed in February 2002, calls them “random shootings”. How did Nottingham get like this?



Poor policing is part of the answer. Though things have improved recently, Nottinghamshire's police have consistently been rated among the worst in the country by government inspectors. “The police didn't solve things, they just tried to find someone to blame for them,” says John Heppell, the local MP.

While the police were looking elsewhere, the number of guns increased. Armed robbery rose sharply in 2002. Guns are cheap, according to research by Jacqueline Schneider, who studies Nottingham's gun crime at nearby Leicester University, though ammunition can be very expensive. The number of guns seized is a rough guide to their prevalence. The 320 officers of London's anti-gun unit, Operation Trident, grabbed 333 firearms last year. In Nottingham, the 17 officers in the equivalent unit, the Stealth team, have taken an average of nine guns per officer. This means the Nottingham unit is now doing a good job. But it also shows that there are lots of guns.

Oddly, the lack of organised crime may also make for more violence. When gangs are fighting for control

of the drug trade, the victims tend to be involved somewhere in the supply chain. That has not been happening in Nottingham. Dan Silverstone of Portsmouth University, who has interviewed people convicted of firearms offences in north-west London, says that when no single group has a monopoly of violence, more people get shot.

Nottingham's gunmen mostly fit the pattern of small-time thugs as opposed to disciplined gangs. “They are not even particularly successful,” says Anna Soubry, a criminal lawyer and Conservative candidate. “They don't have much money.”

The dead have mostly just been passing by. But the shootings have not been entirely random. Nick Holmes, who works on the Stealth team, says there is a pattern of people in particular areas of the city being attacked by gunmen from rival areas as part of feuds going back ten years or more.

“Instead of fighting it out on the streets, there is access to firearms to solve relatively minor disputes,” he says. “That's as sophisticated as it gets.” That the violence springs from such trivial causes does not make it any better for the people who live in St Ann's, where Danielle Beccan was shot. Perhaps, indeed, it makes it worse.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Contemporary art

Philistines flabbergasted

Oct 14th 2004
From The Economist print edition

Fans of contemporary art have the last laugh

ONLY the most fashionable have been invited to the first-night party of London's Frieze Art Fair 2004 on October 14th. It will be packed with art lovers, collectors and celebrities (Jude Law, an actor, and Kate Moss, a model, are promised), and will be followed by a weekend of champagne breakfasts, impromptu performance art and lavish receptions to encourage punters to fork out for works by the hippest of contemporary artists—Gerhard Richter, Cindy Sherman, Matthew Barney, Jake and Dinos Chapman and the like.

“Art is money-sexy-social-climbing fantastic,” said the late Thomas Hoving, ex-director of New York's Metropolitan Museum of Art. That wasn't true in London's staid art market until a few years ago. But now a happy conjunction of all those virtues means that the business is both booming and hip.

The sexiness came first. That was partly down to the brash, entrepreneurial Damien Hirst and friends who got the media interested in the late 1980s with his first show, “Freeze”: at the time, the contemporary art scene in Britain was confined to a moribund Tate, plus a handful of galleries in Cork Street in Mayfair. The only international contemporary art was in Charles Saatchi's gallery in north London. His “Sensation” show at the Royal Academy in 1997, and then the opening of the Tate Modern in 2000, helped change that.

The money followed swiftly. According to a report published by the Arts Council on October 15th, the market for “challenging contemporary art” in London has swollen in ten years from virtually nothing to around £500m ($900m) a year: that's the primary market, for art that's being sold for the first time, and doesn't include the secondary market.

In the past year alone, big international names such as Gagosian, Sprüth Magers Lee and Hauser & Wirth have opened up in the capital. When Larry “Go-Go” Gagosian, America's most powerful dealer, opened his second London gallery—a 12,500 square foot space—earlier this year, he gave a dinner for 200 under the Rubens ceiling at the Banqueting House in Whitehall, Britain's grandest dining venue. Jay Jopling (who represents Mr Hirst and Tracey Emin, two of the big names of BritArt, and is married to Sam Taylor-Wood, a third) is also opening a new gallery in a former electricity substation. There are now around 35 high-end contemporary galleries in London, more than in any other European city. The leading critics and scholars are now all there too.

Old Master, Impressionist, and antique sales used to be the big events for London's auction houses. But François Pinault, who bought Christie's, a posh auction house, in 1998, led the way in focusing the business on contemporary art. The old art world has taken up the new with enthusiasm: the patrician chairman of the rival Sotheby's, Henry Wyndham, has invited Mr Hirst to hold a riotous party at the auction house's New Bond Street saleroom (complete with trademark butterfly wallpaper, sound system and limited-edition invitations) to promote the sale of work from Mr Hirst's defunct Notting Hill restaurant, Pharmacy.

Most of the people buying contemporary art in London are foreign, but even the British are getting into it. The new rich are no longer so interested in the Gainsboroughs, Chippendale furniture and silver they once relied on to help them up the social ladder. It is to contemporary art that new money looks these days for a touch of class. The best indicator of this—as of almost everything in modern life that is money-sexy-social-climbing fantastic—is David Beckham, Britain's best-known footballer: this year he gave his wife a heart-shaped Damien Hirst canvas featuring dead butterflies as a wedding-anniversary present.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Drug treatment

Coming clean

Oct 14th 2004
From The Economist print edition

Mandatory drug treatment is fashionable. Does it work?

WHAT should be done with drug addicts? While drug dealers are a familiar category of villain, it has never been obvious whether their clients ought to be pitied or put away. Increasingly, politicians are trying to have it both ways. David Blunkett, the home secretary, wants to steer 13,000 drug-addled criminals into Drug Treatment and Testing Orders next year: in effect, sentencing them to a cure. David Davis, his Conservative opposite number, has gone one better, declaring that he would give all addicts a stark choice between treatment and prison.

The reason politicians want to get tough on drug addicts is, ironically, connected to a drop in the crime rate. Thanks mostly to plunging prices for stolen goods, burglary and car theft are now about half as common as they were a decade ago. Crafty criminals have either gone straight or moved into more profitable lines of work—drug-trafficking, for example. But that leaves a residue of chemically dependent folk in the old trades. Police in some areas now routinely test people arrested for “trigger offences”, such as robbery and property crime, for drugs. They consistently find that about half test positive for cocaine, opiates, or both.

Prohibition means that drug prices are likely to remain high, and prescribing heroin and cocaine is controversial. So the only option left is to wean people off their expensive habits. Mr Blunkett's new scheme offers a variety of treatments, ranging from methadone to support groups and aromatherapy. Results so far appear unpromising. In March, a National Audit Office report found that 72% of clients were failing or dropping out of the programmes. An independent review by South Bank University found that 80% were reconvicted within two years.

These results are worse than those achieved in many European countries, or in America's “drug courts”, which try to set petty offenders straight through a combination of stern words and affirmation. Some sceptics argue that money (£5,200 to £7,600 per participant in the British scheme) is being wasted, since failure rates are as high, or higher, than cheaper voluntary detoxification programmes.

Widespread failure does not mean that mandatory drug treatment is pointless. Most of those sentenced are already prolific offenders, so reconviction rates are likely to be high. The South Bank University study found that people sentenced to drug treatment in three areas had received, on average, between five and ten convictions in the past year. One energetic villain, in Gloucestershire, had amassed 481. Alex Stevens, a drugs specialist at the University of Kent, says that the sort of people who are picked for mandatory treatment in Britain would, in America, be serving long prison sentences.

Turning extraordinarily prolific criminals into rather more occasional ones (who are likely to continue using hard drugs from time to time) does not sound like much of an achievement. But it may have a striking effect on crime in some neighbourhoods. Mandatory treatment outside a prison is also better than locking people up inside one: detoxification may be available there, but a route to a more stable life is not. While politicians remain in thrall to prohibition, mandatory schemes are probably the best option.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Education

Snooty or what?

Oct 14th 2004
From The Economist print edition

Inverted snobbery prevents good teachers going where they're needed

A CLEVER man wants to do a good thing, but the wicked government stops him. That is the scandalous-sounding story of the difficulties encountered by Tristram Jones-Parry, head of fee-paying Westminster School, one of the best in the country. He retires next year and wants to help teach maths in a state school.

Was he welcomed with open arms? No. He was told, he complains, that he would need retraining for the state system. It was a similar story for David Wolfe, a retired American physics professor who teaches in a British state school. He said this week that the authorities told him to sit the GCSE maths exam normally taken by 16-year-olds if he wanted to continue.

The system is not quite as insane as this might suggest. The rules that require state-school teachers to be formally qualified do have exceptions. The Teacher Training Agency insists that Mr Jones-Parry could gain his ticket in just a day, by having an assessor from the state system observe his work at Westminster (a requirement scarcely less ludicrous than the supposed demand for retraining). Mr Wolfe's American PhD would count as an equivalent to the GCSE maths pass normally required. So he would scrape by as well. The General Teaching Council, another quango, has now apologised to Mr Jones-Parry for giving him the wrong information at first, and then leaving his follow-up letter unanswered for six weeks.

The real story is the gulf between the two kinds of school. Heads like Mr Jones-Parry hire teachers with good academic credentials but not necessarily with state qualifications. State-school hiring is closely regulated; their teachers need to be expert form-fillers and jargon-wielders, and are much less likely to have good degrees: indeed only 38% of state-school maths teachers have a degree in the subject; in independent schools, 63% do.

So it's not surprising that private-school teachers think even the most nominal barriers to their teaching in state schools are offensive and silly. The other side responds in kind: teaching unions this week said snidely that Mr Jones-Parry might be good at teaching advanced maths to well-behaved bright kids, but would not necessarily know how to teach simple sums to rowdy, dim ones. Perhaps. But many state-school parents desperately seeking better maths teaching for their children might consider that risk rather small.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD BRITAIN
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Computerising the NHS

Déjà vu all over again?

Oct 14th 2004
From The Economist print edition

Worries abound over an ambitious project to computerise the NHS

Get article background

IT IS a familiar tale: the government announces an ambitious information technology (IT) project, awards contracts and sets deadlines. But then the costs start to rise and deadlines pass. The project is eventually completed years late, way over budget, and fails to deliver the promised benefits—or is scrapped altogether. Could this be happening to the National Health Service's National Project for IT (NPfIT)?

If so, it would be big blow to the government. The NPfIT is not just another big IT project: lessons from previous fiascos (air-traffic control, benefit cards, the Passport Office, the Child Support Agency) have been applied and new procedures devised: as well as being vital to the future of the NHS, the NPfIT is also intended to show that big IT projects need not always go wrong.

Which explains the outcry this week when *Computer Weekly*, a trade publication with a history of exposing IT disasters, claimed that the Department of Health's internal estimates said that the cost of the project could rise to more than £18.6 billion, and possibly as high as £31 billion—far above the project's current budget of £6.2 billion. The result: wall-to-wall headlines bemoaning yet another IT fiasco.

In addition, the National Audit Office (NAO) has launched an investigation into the NPfIT's procurement procedures, and BT, one of the project's biggest suppliers, has been fined £300,000 for missing deadlines. The Department of Health, however, insists that the NPfIT "is on track and on budget". Is it really?

The apparently soaring costs are in fact the result of comparing apples with oranges. The suppliers involved in the NPfIT were awarded ten-year contracts that run from 2003 to 2013. These are worth £6.2 billion over this period. The bean-counters at the Department of Health, however, seem to have been considering the implementation cost of the project, not the initial procurement cost. An industry rule of thumb is that implementation usually costs between three and five times the procurement cost. Multiply £6.2 billion by three and five, and you get this week's much higher figures.

The figures are, in short, a back-of-the-envelope calculation—and the implementation costs will, in any case, be spread over a decade. At the moment, says Karen Swinden of Kable, a consultancy, the NHS spends around £1.3 billion a year on its existing IT systems. Even if the £18.6 billion figure turns out to be correct, that would correspond to £1.9 billion a year for ten years. Local health trusts are worried that they will have to find the extra money, which could mean making cuts elsewhere. But the government says it always planned to spend up to 4% of the overall NHS budget, which is due to increase to £90 billion by 2007-08, on the NPfIT. So talk of vast unforeseen expenditure and cuts in other areas, says a spokesman at the Department of Health, is "complete nonsense".

What of the project's other problems? Despite hand-wringing by opposition MPs, the NAO's investigation is entirely routine for a project of this size. As for BT's fines, these could be taken as evidence that the project is going well. BT is the only supplier to have been fined so far, which suggests that the threat of financial penalties is forcing suppliers to meet their targets. The much-trumpeted appointment-booking system was switched on during the summer as planned, and is being quietly tested, notes Tola Sargeant, an analyst at Ovum; but a new e-mail system, switched on last week, is having teething problems. So it is still too early to tell how well the project is doing.

The crunch, it seems, will come next April, since several implementation deadlines fall at the end of the financial year. Richard Granger, the civil servant in charge of the NPfIT, recently predicted that there would be “a tipping point around Easter”. The government must be hoping he is right—good news around then would be nicely timed for a May election.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

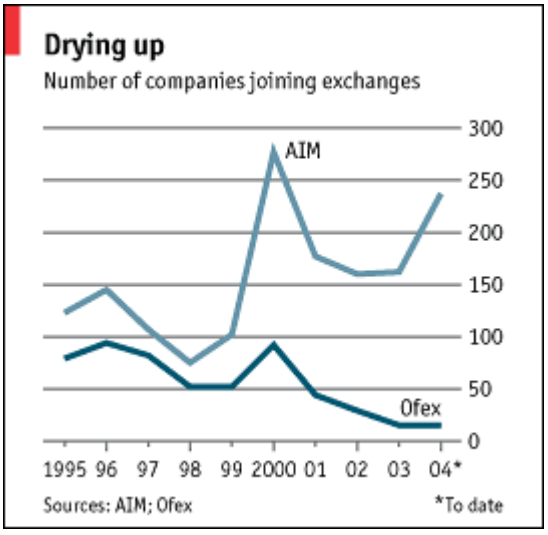
About sponsorship

Stock exchanges

Crowding out

Oct 14th 2004
From The Economist print edition

Ofex and AIM: a tale of two markets



LONDON'S Stock Exchange needs little introduction. Most financiers will have also heard of its junior relation, the Alternative Investment Market (AIM). But Ofex, Britain's third (and smallest) stock exchange, is in the news only now that its survival is threatened. Founded in 1995, it has listed more than 500 small firms, including a few well-known outfits like Arsenal, a football club, and Weetabix, a breakfast cereal company.

But the miniature bourse is running out of customers and money: 24 firms had left by July this year—six of these to AIM—up from 19 in the same period last year. Only eight companies have been admitted to replace them. By contrast, AIM added 85 new firms over the same period. Last month, Ofex said that it would be unable to carry on beyond November. Its share price (listed, ironically, on AIM) fell 79%, from 21p to 4.5p. Since then Zyzygy, a private finance consortium, has expressed an interest, along with several other investors.

That may stave off disaster, but it will not solve Ofex's fundamental difficulty: lack of liquidity. Whereas AIM is enjoying a virtuous spiral, with new listings attracting new investors and vice versa, Ofex is suffering the opposite.

So what can Ofex do? Run itself better, for a start. Its problems have been compounded by having only a single market-maker, owned by the bourse's founder, John Jenkins. When three more firms were appointed in July, spreads shrank and trading rose. Other measures are being tried, too: Simon Brickles, a former head of AIM, has been brought in, and the board has plans for a two-tier market, with a premier section designed to show off the best and brightest firms. Another idea is to attract more foreign companies. But it is hard to see why they should prefer Ofex to AIM, which already lists 94 foreign firms.

More realistically, some Ofex boosters reckon that AIM's success in attracting medium-sized firms means that Ofex can thrive in its niche serving the tiddlers, who want to raise £5m or less. Perhaps. But tiny firms may find it easier to approach a bank or a private backer for such modest sums, rather than go to the trouble of a market listing.

The question is whether there is actually room for a third-tier stock market in Britain. City opinion is divided, but the markets themselves show signs of optimism: after the approach from Zyzygy was announced, Ofex shares jumped by a stonking 83%, to 8.25p.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD BRITAIN
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Bagehot

Mr Blair goes big

Oct 14th 2004
From The Economist print edition

Tony Blair may not know it, but his experience is of greater value to the government than his vision

TONY BLAIR has made more passionate speeches. And there have been plenty of times when the drama of the occasion had a greater intensity. But rarely has he made a speech that has had to work harder or prove more points than the one he delivered this week on welfare reform at London's Beveridge Hall.

Following his declaration a fortnight ago (on the eve of a procedure to correct a heart flutter) that he intends to leave office only after serving a full third term, Mr Blair has to demonstrate he is both up to it and up for it. Were there to be the slightest doubt about either, political authority, being what it is, would leach inexorably and rapidly.

Mr Blair's physical health is unlikely to be his biggest problem: the procedure he underwent has a high success rate. The prime minister looks revoltingly fit for a middle-aged man who signally fails to practise what he preaches about work-life balance. Far less certain is whether Mr Blair can convince a growing army of sceptics that there is more than the most tenuous connection between the hyperbole he is so given to and his ability to drive through changes that improve people's lives. Last week, Michael Howard, the Conservative leader, scored a palpable hit when he sneered: “Most people don't actually want a date with destiny; they just want a date with a dentist.”

Mr Howard was tapping into the widespread belief that for all the money the government has lavished on public services, and for all that Mr Blair, in particular, has banged on about the importance of the reforms accompanying the spending, there is little to show for it. A Tory government, says Mr Howard, would provide less uplift and a great deal more zeal in delivering the things that people really want, such as clean hospitals, orderly schools and safer streets.

Mr Howard may be on to something, if only because of the contrast with Mr Blair. The prime minister has a strong sense of what he is “for”. And one of the things he reckons he is “for” is what he unapologetically described this week as “grand visions and great causes”. Effective politics, he believes, demands a synthesis of the practical and visionary. He has never had much trouble with the vision thing. As he inelegantly put it, he likes to “go big”. But these days, he also thinks he has become good at relating that larger picture directly to workable policies.

While others may calculate (and hope) that having signalled his retirement date, albeit one that is notionally more than four years distant, he is a lame duck; Mr Blair is convinced that he is at the very height of his powers.

To show how busy he intends to be during the rest of his time in Downing Street, the prime minister described how by meeting seven “challenges”, a new sort of welfare state would be formed “with the citizen not at the bottom of the pyramid taking what is handed down; but at the top of it with power in their hands to get the service they want.” The result would be a “genuine opportunity society” in which the aspirations of today's middle classes would become those of the working class.

Mr Blair clearly doesn't admire what he sees as the minimalism of the Tory offer. The Tories have a list of things they don't like, but in Mr Blair's view, they don't know how to weave together the threads to make a seamless and compelling story.

But for Mr Blair there is danger of a different kind. He underestimates the fatigue his ritual overclaiming induces, even among those who are broadly sympathetic to his aims. Mr Blair insists that he is “transforming” things, when most people would be grateful if he just succeeded in improving them a bit.

He bangs on about “boldness” and “challenges”, when, in truth, most of the policies a third-term Labour government would implement, such as overhauling vocational education, introducing a decent system of child care and helping more drug users to beat their addiction, are worthily uncontroversial.

It's the levers, stupid

There are two important exceptions. Mr Blair really will have to show some political nerve when it comes to reforming pensions and incapacity benefits. As far as pensions are concerned, Mr Blair's hope that Adair Turner's painstaking examination of all the options (see article) will pave the way for a new consensus on what should be done is likely to be dashed. It is far from clear how a move away from means-testing, desirable though it may be in principle, can be reconciled with Gordon Brown's determination to use the limited resources available to help the poorest pensioners. The prime minister and the chancellor could also come to blows over how far to go in finding ways to propel a large proportion of the 2.7m recipients of incapacity benefits back into the labour market. Nobody is keener than Mr Brown on welfare-to-work, but he is intensely wary of appearing to confront the disabled lobby.

But those major reforms apart, the real test for Mr Blair's remaining time in government, for all this week's rhetoric, is administrative rather than political. That is partly because Mr Blair has already won quite a lot of the important arguments (conducted mostly with his own party), for example, over bringing independent suppliers into the health service and introducing variable university tuition fees. He has been much less successful, however, in operating the levers of Whitehall power. Too often, ambitious policies have been announced, but in the world beyond Downing Street nothing much changed. More than the boldness that Mr Blair likes to identify himself with, what is needed now is doggedness, guile and experience.

After over seven years in office, it would be surprising if Mr Blair had not become a tougher and more wily character. He may think it is his vision that makes him indispensable to his party. But it is other qualities that will determine whether or not he was wise to carry on.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

The luck of the Irish

Oct 14th 2004
From The Economist print edition

Photocall Ireland

The economic boom that spawned the "Celtic Tiger" has transformed Ireland. But, asks John Peet (interviewed here), can it last?

SURELY no other country in the rich world has seen its image change so fast. Fifteen years ago Ireland was deemed an economic failure, a country that after years of mismanagement was suffering from an awful cocktail of high unemployment, slow growth, high inflation, heavy taxation and towering public debts. Yet within a few years it had become the "Celtic Tiger", a rare example of a developed country with a growth record to match East Asia's, as well as enviably low unemployment and inflation, a low tax burden and a tiny public debt.

The Economist proved no better than anyone else at predicting this turnaround. Our most recent previous survey of Ireland, "The poorest of the rich", published in 1988, concluded that the country was heading for catastrophe, mainly because it had tried to erect a welfare state on continental European lines in an economy that was too poor to support one. Yet only nine years later, in 1997, Ireland featured on *The Economist*'s cover as "Europe's shining light" (see article). It goes to show how remarkable has been the transformation of a sleepy European backwater into a vibrant economy that in some years grew by as much as 10%.

That transformation has made the Irish republic, with just over 4m people, a place of great interest around the globe. Many rich countries, not least Ireland's sclerotic neighbours in western Europe, would love to achieve a similar change of image. The eight central European countries that joined the European Union in May seem fascinated by Ireland. Civil servants and businessmen in Dublin talk wearily of a procession of visitors from such places as Vilnius and Bratislava, anxious to emulate Ireland's leap from one of the EU's poorest members in the 1980s into one of its richest (see chart 1). They all promise that they will make good use of EU money, as Ireland did, and avoid the fate of Greece, which in the 1980s was not far behind Ireland but has since been left standing.

Punching above its weight

The world's interest in Ireland is not confined to its rags-to-riches story. Thanks partly to the Irish diaspora, created by a century and a half of emigration, the country has far more clout than its small population might suggest. It had a notable stint on the United Nations Security Council in 2001-02. And Europeans were impressed by the Irish presidency of the European Union in the first half of this year, which took in not only the eastward expansion of the EU and the choice of a new commission president, but also a deal on a new EU constitutional treaty, brokered by the Irish taoiseach (prime minister), Bertie Ahern. On a less elevated level, the main streets of cities the world over feature “Irish pubs” serving draught Guinness.

Over the border, Northern Ireland, which has a population of 1.7m, offers a valuable case-study in how to resolve an entrenched terrorist problem. The peace process in the province remains partial, bumpy and incomplete (only last month British, Irish and Northern Irish leaders failed yet again to agree on a precise formula for the revival of devolved government in Belfast). Yet ten years of painstaking diplomacy, by both the British and the Irish governments and by politicians and paramilitary leaders on both sides of the sectarian divide in the north, have largely put an end to the violence that for two decades disfigured Northern Ireland. Other countries with intractable terrorist problems might take note.

Peace in Northern Ireland has helped to boost the economy of the whole island. A visitor to Dublin, so lively and cosmopolitan today, would find it hard to believe that only a few decades ago it was gloomy and depressed. In the 1960s Ireland's heavily agricultural economy, almost wholly dependent on exports to Britain, was only just emerging from the misguided protectionism that since the 1930s had been the main plank of Eamon De Valera's ill-advised economic policy. Ireland had missed out almost entirely on Europe's post-war boom; living standards were stagnating and emigration was in full flow. In 1960 the republic's population was down to around 2.8m, the lowest in two centuries and a pale shadow of the 8m (for the whole island) in 1840, when this was one of the most densely populated countries in Europe. Many wondered if Ireland had a future.

In fact, the 1960s proved something of a turning-point. Corporate tax on foreign multinational companies investing in Ireland was cut to zero in 1957. Belatedly, the country embraced free trade with Britain and, by joining the European Economic Community in 1973, with much of the rest of Europe. The combination of zero corporate taxes, a low-wage economy inside the EEC and a shared language proved a strong lure for American manufacturers. Ireland's long love affair with foreign direct investment (FDI) began in the 1960s. Free secondary education for all arrived in 1967, and after 1973 Irish farmers benefited from Europe's munificent farm subsidies.

This promising start, however, was kyboshed by the two oil shocks of the 1970s, and even more by a knuckle-headed policy response. Successive Irish governments sought to offset the cut in living standards imposed by higher oil prices through fiscal and monetary expansion. The result, ultimately, was the high inflation, high unemployment, slow growth and even electoral instability that marred the 1980s. Emigration, especially of graduates, hit new highs. At the start of the third Haughey government in 1987, a grim joke made the rounds: would the last Irishman to leave please turn out the lights? Yet only a few years later the Irish miracle had arrived. What caused it? Can it be replicated? And can it last?

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Tiger, tiger, burning bright

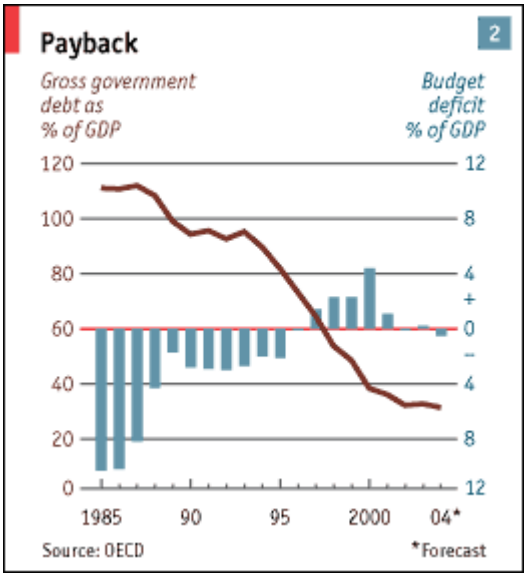
Oct 14th 2004
From The Economist print edition

Photocall Ireland

An economic miracle with many causes

THE figures recording Ireland's transition from Europe's worst- to its best-performing economy are remarkable. In 1987 Irish GDP per person was 69% of the EU average (adjusted to EU 15); by 2003, it had reached 136%. Unemployment fell from 17% in 1987 to 4% in 2003; and government debt shrank from 112% of GDP to 33% (see chart 2). Annual GDP growth in the decade of the 1990s averaged a tigerish 6.9%; GNP growth, usually a more appropriate measure for Ireland (see article), only slightly less. Perhaps even more impressive, after a downward blip coinciding with the American and, especially, the information-technology (IT) slowdowns in 2001-02, the economy is bouncing back: growth both this year and next is expected to be around 4-5%.

Not surprisingly, this Celtic miracle has been carefully analysed. Many different, and sometimes contradictory, explanations have been proposed, but as usual there is no single cause: it was a combination of different factors at different times.



To get a more complete answer, it also helps to ask a different question altogether. Seen in a historical context, what is striking about Ireland is not that it grew so spectacularly in the 1990s, but that it did so badly in the 1980s, and indeed for a long time before then. At independence in 1922, Ireland was as rich as most European countries, and only a bit poorer than Britain. But by 1960 it had fallen far behind, and continued to lag the rest of Europe until the late 1980s. On this reading, the emergence of the Celtic Tiger was a belated catch-up after years of underperformance.

There were, nevertheless, a number of special factors that changed Ireland's fortunes after 1987. Here are some, in ascending order of importance:

•**Fiscal and monetary consolidation**. Charles Haughey's Fianna Fail government, crucially supported by the opposition Fine Gael, started to cut spending, taxes and borrowing. Falling interest rates helped to stimulate the economy, and so did a currency devaluation in 1993. The launch of the euro in 1999 gave Ireland, a founder member, the benefit of lower—perhaps unduly low—interest rates.

•The tax cuts were also a critical component of a new **social partnership**. Unlike Britain, where the Thatcher government shifted decisively against corporatism, the Irish resuscitated social dialogue in 1987, with trade unions accepting wage restraint in exchange for more policy influence and tax cuts. Seventeen years on, unions and employers still talk up the advantages of social partnership. Even the tanaiste (deputy prime minister) and leader of the free-market Progressive Democrats, Mary Harney, considers this an important part of Ireland's success.

•**European Union subsidies**. Countries such as Germany, the chief EU paymaster, like to argue that

Ireland's miracle was due to huge transfers from Brussels. Yet European money had been pouring into Ireland since 1973, at first to little obvious effect. The expansion of the EU's structural funds after the Maastricht treaty of 1992 was helpful, but even then transfers never exceeded 5% of Irish GDP, a far smaller proportion than, say, west German transfers to east Germany. The most authoritative studies suggest that EU subsidies may have added around 0.5% a year to growth during the 1990s—useful, but modest in the context of average growth of 6.9%.

•More important than EU money may have been the 1992 programme to create a **European single market**. As a big low-cost exporter to Britain and the rest of Europe, Ireland benefited from more open access. EU subsidies also played another indirect part: by requiring a planned capital programme some years ahead, they helped to protect badly needed infrastructure projects from the cuts imposed in response to the fiscal pressures of the 1980s.

•**Ireland's FDI boom**. A number of foreign manufacturers invested during the 1960s, lured by the country's low costs and zero corporate-tax rates. Among them were such high-tech companies as Polaroid and Digital Equipment. But by the 1990s they had pulled out, as did Gateway, a PC-maker. By then, after complaints from the EU, the corporate-tax breaks had become less generous (from this year the rate for all companies is 12.5%). But Ireland's Industrial Development Authority (IDA) had become good at attracting desirable companies, and it proceeded to win big FDI projects in such businesses as software, semiconductors, personal computers, pharmaceuticals and medical devices.

•**Education**. One of Ireland's bigger attractions was a ready supply of skilled workers, including scientists, engineers and business-school graduates. As far back as the 1960s, the country had been investing heavily in both secondary and higher education. Dublin's two main universities, but also those at Cork and Galway, and a new one at Limerick, became crucial to the IT, pharmaceutical and health-care companies that invested in those regions.

•**Low personal taxes**. In the 1960s and 1970s, high income-tax rates, and a high tax burden in general, discouraged domestic growth, but from the early 1990s taxes started to come down sharply, giving a big boost to home-grown enterprise. Des O'Malley, who quit Mr Haughey's Fianna Fail party to found the Progressive Democrats in 1985, says that lower income-tax rates were key to the Irish miracle.

•**Demographics**. The baby boom in Ireland lasted longer than in the rest of Europe, and there were fewer elderly pensioners because emigration in the 1950s and 1960s had been so heavy. Where other European economies were facing a rapidly ageing population, Ireland has been boosted by its youthfulness. Ireland's population has been growing strongly for 13 years now, helped also by an end to the net outflow of people and the start of an inflow.

Photocall Ireland

Enjoying the boom while it lasts

•The biggest contribution to the Irish miracle, however, came from **more people working**. Until the 1980s, women's participation in the workforce was low by international standards; today it is above average. Conversely, Irish unemployment was high, at around 17% in 1987; today it is 4%. All in all, the labour-force participation rate in Ireland has risen from around 60% in the 1980s to almost 70%. The absolute numbers of those in work rose from 1.2m in 1993 to over 1.8m ten years later. On some estimates, this accounts for half of Ireland's growth in the 1990s.

Unrepeatable

Does it matter which of these explanations for Ireland's success counts for most? Yes, for two reasons. The first is that many of them were one-offs. European subsidies, for example, are a thing of the past now that Ireland has become one of the EU's richest countries. Likewise, the stimulus to growth from the lower interest rates that came with the European single currency will not be repeated. And the sharp rise in labour-force participation is over and done with. Although the Irish population remains relatively young, it is beginning to look a lot more like that of the rest of Europe, with a falling birth rate and a rising proportion of old people.

The conclusion is stark: much of the Irish miracle (ie, higher output) was attributable to one-off changes (ie, greater input) and not to productivity growth (ie, more efficient use of that input). In effect, an economy that was suffering from 50 years of inefficiency, poor organisation and under-use of inputs (especially female workers) has spent the past 15 years catching up with more efficient, better-organised neighbours. Now it needs to find ways to keep the momentum going.

The second reason why there is so much interest in the secret of Ireland's success is that many countries in central and eastern Europe want to emulate it. This will not be easy. Some may be able to increase their female labour-force participation, but most will find their demographics a hindrance rather than a help. They can aim for better education, more foreign direct investment and fiscal and monetary consolidation, but such measures take years to produce results.

The new EU members will also discover, as Ireland has already done, that the world has become a lot more competitive. Ireland has some useful advantages to help it stay ahead, but it also faces serious short-term problems, such as the state of some public services and a dangerous obsession with property.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Measure for measure

Oct 14th 2004
From The Economist print edition

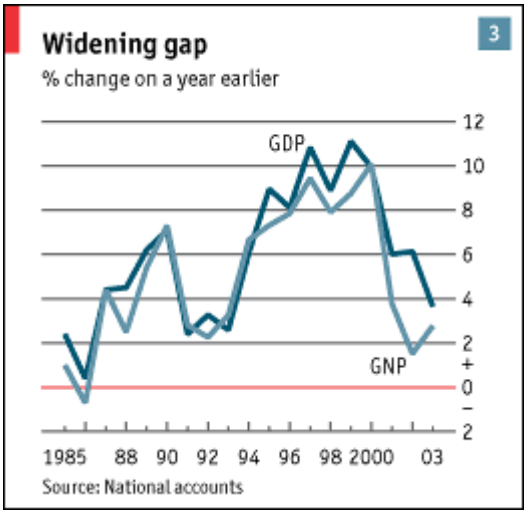
The tangled tale of GDP and GNP

ANY first-year economics student knows that national-income figures can be collected in three different ways, using income, output or expenditure numbers. Although the three are supposed to produce the same result, they rarely do. But the differences are tiny compared with a more obscure oddity that affects the Irish economy: the huge gap between gross domestic product (GDP) and gross national product (GNP).

GDP is the more common measure of national income, to which GNP adds an item known as net transfers of factor incomes. This means adding the overseas profits of Irish companies that are repatriated to Ireland, and subtracting the profits of foreign multinationals operating in Ireland that are sent abroad. In most countries the two numbers will be small, and may also broadly balance out. But because of Ireland's large FDI base, coupled with its enticingly low corporate taxes, lots of big foreign companies make (or at least report) big profits in Ireland which they transfer back to their head offices. As a result, Ireland's GNP is as much as 25% smaller than its GDP.

What this means in practice is that GDP figures overstate the national income available to Irish people to spend. Ireland's diplomats in Brussels wised up to this long ago. When they want to crow about the brilliant economic policies that created the Celtic Tiger, they use the GDP figures, noting proudly that Irish GDP per person is now the third-highest in the EU, well above Britain's. However, when the talk turns to EU regional subsidies, the diplomats switch to the “more appropriate” GNP measure, which puts Ireland close to the EU average, and mutter about the country's huge infrastructure backlog.

As the Irish economy develops, GDP and GNP might be expected to converge, but instead the gap seems to have widened recently (see chart 3). That is largely because American multinationals have been racking up (or at least recording) such big profits in Ireland. In some ways, this is a mark of the country's economic immaturity, and its failure to nurture indigenous industry. Chris Coughlan, a vice-president of HP Compaq and chairman of the Galway Chamber of Commerce, suggests that Ireland's future success could be measured in part by whether GDP and GNP converge, which would indicate that home-grown industry has matured. That might, sadly, put an end to another splendid quirk with which to confuse those first-year students: that Ireland's total exports exceed the country's national income.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Why worry?

Oct 14th 2004
From The Economist print edition

Photocall Ireland

The economy has some weaknesses—but several strengths too

IF THE Irish miracle materialised so quickly, might it as suddenly vanish again? The country faces more intense competition than it did, often from lower-cost rivals that are becoming equally adept at attracting FDI, investing in education and encouraging indigenous industries. But there are also more specific concerns.

Some of the biggest are macroeconomic. Ireland's fiscal position, which in the 1980s put the country in danger of default, is today enviably healthy. But a pre-election spending splurge in 2001-02 has had to be sharply cut back; and the country still needs to spend a lot more on infrastructure. The long-serving, tough-minded finance minister, Charlie McCreevy, has gone off to a job in the European Commission in Brussels, and his successor, Brian Cowen, may find it harder to keep the lid on spending.

Ireland also suffers from an acute monetary-policy dilemma. In the run-up to the launch of the euro in 1999, Irish short-term interest rates were cut sharply. The result was an extra stimulus to an already fast-growing economy, a burst of renewed inflation and a further ratcheting-up of property prices, especially in the Dublin area. The subsequent depreciation of the euro made matters worse. Fortunately, a sclerotic European (and, by 2001, world) economy held prices down, so that inflation has remained relatively low, although higher than elsewhere in Europe. But interest rates, set in Frankfurt by the European Central Bank, are still far lower than Ireland would choose for itself.

Higher inflation than in rival countries means that Irish competitiveness is being steadily eroded. Moreover, if the euro appreciates further against the currencies of Ireland's two biggest trading partners, America and Britain, Irish exports will be hurt. Even more serious, low interest rates have helped to cause a property frenzy, particularly in the greater Dublin area, in which average house prices have quadrupled over the past decade, with household debt expanding to match.

Ireland is not the only country to have experienced a housing bubble in recent years. But it may be peculiarly vulnerable, because as a member of the euro area it cannot raise interest rates in order to prick the bubble. Moreover, in the past decade or so property and construction have become unduly dominant in the economy (and in politics too, see article). This year, for example, Ireland is on course to build almost 80,000 new houses. Britain, which has 15 times as many people, builds only twice as many. Employment in construction has almost doubled in the past decade, and the sector accounts for some 15% of national income—over twice as much as in Britain.

Ireland is also exposed to property prices abroad. The Irish, like the British, have always liked property portfolios. Various London landmarks, such as Claridge's, the Connaught hotel and the Unilever building, are Irish-owned. The banking system is heavily exposed: the big Irish banks, such as Bank of Ireland and Allied Irish, are in effect mortgage banks, observes Colm McCarthy of DKM Economic Consultants. A property crash would badly hit their balance sheets.

The dominance of Dublin is another risk factor. The city and its region contain almost a third of the Irish population and generate close to 40% of GDP. Dublin is also a surprisingly spread-out city, with low-density Georgian streets at its heart, big parks and almost no high-rise buildings. Two consequences are

giddy house prices and long commutes for those who cannot afford to pay them.

Clearly there are big risks ahead, with a property crash perhaps the most threatening. But the gloom can be overdone. Ireland also has a number of plus points that should help it grow rapidly.

The big magnet

For a start, there is an impressive FDI machine, led by the IDA but with help also from Science Foundation Ireland, Forfas and Enterprise Ireland, which fosters indigenous industry. The IDA is a world-class agency, able to compete not just with the rest of Europe but with places such as Singapore and Taiwan for valuable projects in pharmaceuticals, biochemistry, IT and medical devices. Its roster of satisfied investors, mostly but not exclusively from America, remains impressive.

Ireland takes roughly one-quarter of all American FDI in Europe. It now has over 1,100 multinational companies, which export goods worth some $60 billion a year. In certain sectors it is pre-eminent; for example, it takes almost one-third of all FDI in Europe in pharmaceuticals and health care. Nine of the world's top ten drug companies are present (the republic produces most of Europe's supply of the drugs Viagra and Botox). One-third of all personal computers sold in Europe are manufactured in Ireland. The country is the world's biggest software exporter, ahead of America. And Dublin's International Financial Services Centre, about which many were once sceptical, has become a big success, employing some 16,000 people.

The companies that have come to the emerald isle seem delighted with it. At Leixlip, west of Dublin, Intel has invested some $5 billion in its biggest semiconductor plant outside America; it has just started operating Fab 24, the most advanced chip-making facility in the world. Wyeth has chosen Dublin as the site for one of the world's biggest bio-pharmaceutical centres. Dell's personal-computer plant in Limerick is one of the company's most productive. HP Compaq is the biggest employer in Galway, with its main plant on the site of the Digital Equipment venture that went wrong in the 1990s. Apple has chosen Cork for its chief European software-development and support centre, although it has shifted most manufacturing to the Czech Republic and Taiwan.

The Apple story is a symbol of a broad change. As Joe Gantly, its outgoing vice-president, notes, in 1997 the company employed 1,800 people in Cork, 90% of them in manufacturing. But as Ireland saw its low-cost advantage erode over the next few years, most of those jobs were lost. Instead, Mr Gantly persuaded the firm to move into higher-value-added operations, concentrating most European support services and research in Cork. Today it employs just over 1,400 people there, most of them skilled graduates; only 15% of them are in manufacturing.

Brains in clover

That, writ large, is what the country now has to do. At Science Foundation Ireland, Bill Harris uses public money to lure top scientists and researchers to Ireland. His goal, he says, is to make Ireland “science-friendly and friendly to scientists”. Many of his targets are Americans with Irish roots, rather like himself. He trumpets the recent investment by Bell Labs in top-end research, and he works closely with universities. University heads such as John Hegarty at Trinity College, Dublin, and Hugh Brady at University College, Dublin, have spent time in America and brought back an American fervour for links between universities and high-tech industry.

Rex Features

Gerry Wrixon, president of University College, Cork, is typical of the breed. After graduate work and an academic career in America, he came back home to run Ireland's National Microelectronics Research Centre before moving on to UCC, where he seems to spend as much time on links with business and industry as on students. He sees Stanford University and its relationship with Silicon Valley as a model to aspire to, and unabashedly proclaims that, if a university is to thrive, it must be a research-based, elite institution. It is a far cry from the mass universities, with poor links to local industry, that are the norm in continental Europe.

The universities are also integral to another big challenge for Ireland, which is to foster home-grown industry. There are few well-known big Irish companies beyond the Kerry Group (foods), CRH (building materials), Jefferson Smurfit (paper and packaging) and Ryanair. And none is in the booming sectors that dominate FDI in Ireland, notably IT, health care and pharmaceuticals. Such firms as Elan (drugs) or IONA Technologies are successful but small (and Elan has had a big accounting scandal). Yet a growing venture-capital industry is spawning new companies. One example is Multis in Galway, a “re-manufacturer” of computer parts for HP Compaq and Sun Microsystems. The country needs more firms of this sort if it is to stay ahead.

It also needs a strongly pro-business government. The 1980s taught politicians from all sides the folly of high taxes, extravagant spending and other anti-business policies. The present Fianna Fail-Progressive Democrat coalition, led by FF's Bertie Ahern as taoiseach, but with the formidable Mary Harney as tanaiste in charge of industry and enterprise, and Charlie McCreevy as finance minister, has won plaudits from Irish and overseas businessmen alike. In EU meetings, Ms Harney and Mr McCreevy have become renowned for fighting for economic reform and against tax harmonisation—their keenest allies being the British.

Ms Harney recently took delivery of a new report on enterprise strategy by a committee chaired by Eoin O'Driscoll, managing director of Aderra, which argues not only for more emphasis on high-value-added sectors and scientific research but also for greater efforts in marketing and promotion, in which Ireland has been weak. She wants to push through the report's recommendations, and thinks Ireland needs the spur of more competition if its domestic industry is to prosper.

But Mr McCreevy has gone to Brussels, Ms Harney has now taken the health portfolio, and Mr Ahern's low popularity has put him under pressure to shift leftwards. Suddenly Irish politics has become very important for the country's economy.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

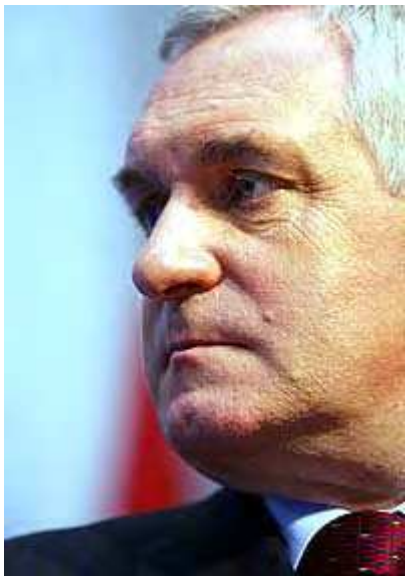
Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Civil-war politics

Oct 14th 2004
From The Economist print edition

Ireland's political system still reflects the struggle for independence

Photocall Ireland



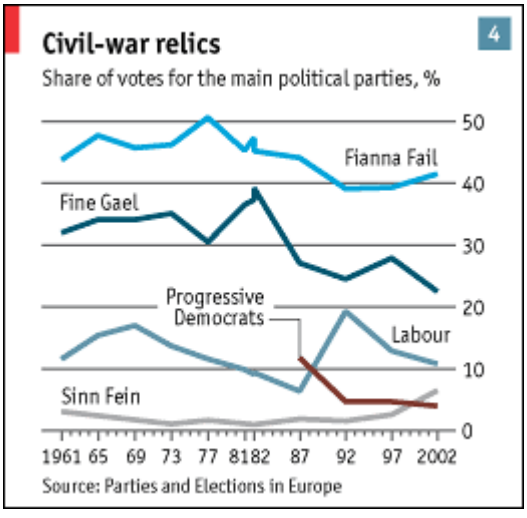
Eyes right for Ahern

ALL countries are shaped by their history, but in Ireland, south and north, history is ever-present and inescapable. Other things being equal, knowledge of the past is surely a plus. But other things are not always equal, and the trouble in the north caused by commemorations of battles fought several centuries ago invites the question whether a country can have too much history. Certainly, history has shaped Ireland's main political parties.

Most European countries have a centre-left (broadly socialist) party and a centre-right (broadly conservative or Christian Democrat) one, perhaps with some liberals in the middle, plus a green party and a few regional or fringe ones thrown in for a dash of colour. Ireland's parties do not conform to this model (nor do Northern Ireland's, see article). The political differences between the two main parties, Fianna Fail and Fine Gael, can be hard to detect. As a telling piece of evidence, try asking a political insider in Dublin where the parties sit in the European Parliament: the odds are that he will not know. (Answer: Fine Gael is part of the centre-right European People's Party, and Fianna Fail sits, bizarrely, in the Europe of Nations group, with Italy's former fascists and the anti-EU League of Polish Families.)

The main point about the two parties is not what they stand for now, but that their forebears fought each other in the civil war of 1922-23. Fianna Fail was founded by De Valera, who opposed the treaty of independence, whereas Fine Gael emerged from the party that supported it. If Ireland has a natural party of government, it is Fianna Fail. It has been in government for 54 of Ireland's 82 years of existence and has long had the biggest share of the vote (see chart 4). It touched a moral low under Charles Haughey in 1987-92, when ministers were taking cash from property and construction interests. That period is now under minute scrutiny in a string of official tribunals.

The tribunals are likely to produce further embarrassing revelations, mostly about Fianna Fail politicians. And yet the party seems to have escaped the worst of the fallout. Indeed, it is in government again, under Bertie Ahern, who has been taoiseach since 1997. This time, shrewdly, he has formed a coalition with the Progressive Democrats, a free-market liberal party led by Mary Harney.



To an outside observer, Mr Ahern personifies the Irish politician. He is a cheerful, ruddy-cheeked man with the gift of the gab, a ready handshake for potential voters and a big smile at such exuberant events as the Galway races (see article). So far his government has proved surprisingly robust, serving out a full term in 1997-2002 and on course to serve out another before the election due in 2007. Mr Ahern has become a close friend and ally of Tony Blair, Britain's prime minister: the two have devoted much time to trying for a peaceful settlement in Northern Ireland. Mr Ahern's government has also cut taxes and, except in 2001-02, held down public spending. Ms Harney is a doughty champion of tax cuts, who claims that reductions in corporate and capital-gains taxes have actually produced higher revenues.

Unloved

Unfortunately the Ahern government is now having to cope with an acute attack of mid-term blues. The fear is that Mr Ahern will try to make himself more popular by shifting leftwards and letting public spending rip, yet the taoiseach insists that he is not changing course. He points to his government's tough action in 2002 to curb public spending, which has been rewarded with renewed growth. He is not about to change tack and jeopardise his government's economic record (and maybe risk losing the Progressive Democrats from his coalition as well).

Instead, he talks of two big challenges ahead. The first is the need for an Ireland that has shed much of its cost advantage to shift further towards services and high-tech industry. The second may be even tougher: to reform public services. Thanks in part to its inheritance from Britain, the Irish civil service is efficient and, by most standards, free of corruption. But, as elsewhere, public services are insufficiently responsive to customers and often fail to deliver value for money.

The boom years of the Celtic Tiger allowed the country to pour money into education and health care. Mr Ahern points out that annual public spending on health, education and welfare combined has risen from €9 billion in 1997 to €26 billion ($32 billion) now. Public-service workers have also benefited from a "benchmarking" exercise that, under the guise of keeping public-sector pay competitive, has made it harder to control spending.

Mr McCreevy notes that health spending alone has tripled during his time as finance minister, from €3.5 billion to over €10 billion, with the numbers of front-line staff rising from 58,000 to 96,000. Yet as other countries are finding, what matters in health care is not necessarily spending more money, but getting a more efficient service. And here Ireland is behind the rest of Europe: doctors remain unaccountable, patients are not treated as consumers, choice is limited, and many hospitals are too small to be effective. Reform will be a challenge even for the tough Ms Harney to deliver, not least because Ireland's multi-member constituencies, combined with its peculiar system of proportional representation, give local issues (such as closing hospitals) undue political weight.

Mr Ahern has also made enemies in the civil service by proposing to move entire departments out of Dublin. This attempt at decentralisation has run into fierce opposition, and not just from senior officials who have no desire to go. Ed Walsh, who established the University of Limerick, has become a vocal critic, arguing that intelligent policymaking across departments becomes impossible if they are physically far apart. A better idea might have been to put the capital in another place, but that would be unpopular with the politicians. Mr Ahern insists that he will stick to his decentralisation plans, though he is willing to negotiate over details and timing.

What of the opposition parties? Fine Gael has changed leaders repeatedly since Garret FitzGerald was taoiseach in the 1980s. The current incumbent, Enda Kenny, has yet to make a big impression, but the party did well in June's European and local elections, when Fianna Fail got its lowest share of the vote since the 1930s. When Fine Gael was in office in 1994-97, under John Bruton, it was in a "rainbow" coalition with Dick Spring's Labour Party; the two parties now talk openly about roping the Greens into a future coalition.

Even so, no opposition party finds it easy to attack the Ahern government. Labour's leader, Pat Rabbitte, admits that Fianna Fail has reinvented itself as a modern progressive party since Mr Haughey's day, but he hopes that revelations from the tribunals may dent the party's support.

All parties are, however, worried by a new factor in Irish politics: the rise of Sinn Fein, the political wing of the Irish Republican Army (IRA). As the main pro-independence group, Sinn Fein set up Dail Eireann, the Irish parliament, in 1919. But after the civil war and the establishment of Fianna Fail and Fine Gael, it was eclipsed, even though the IRA remained active. Now, however, Sinn Fein has grown to become the biggest nationalist party in the north, where it confronts Ian Paisley's Democratic Unionists. Less noticed overseas, Sinn Fein has also garnered support south of the border, where it now commands getting on for 10% in opinion polls.

From which party is Sinn Fein drawing its support? Most of its followers are urban and relatively poor, so they have probably come partly from Labour and partly from Fianna Fail. The leaders of these two parties say that Sinn Fein will hit a natural ceiling of a bit less than 15%. That may seem small; yet as Michael McDowell, the (Progressive Democrat) justice minister, observes, Sinn Fein's platform is essentially a Marxist one. Besides, it still has an armed wing, in the shape of the IRA. Both Mr Ahern and Mr McDowell

pointedly note that Sinn Fein is surprisingly well-organised and financed, and Mr McDowell openly questions the source of the party's money. Asked what single action might do most to reduce its income, he suggests that equalising diesel taxes on both sides of the border would have a salutary effect because it would cut smuggling.

It is possible that Sinn Fein might mature into a legitimate nationalist party: were it ever to be considered as a potential partner in a coalition government, it would have to. But even in its present guise, as a neo-Marxist party with guns, it will not disappear. Its new-found respectability has become part of the price that both parts of the island have had to pay for ten years of peace in Northern Ireland.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Horses for courses

Oct 14th 2004
From The Economist print edition

Corbis

The beauty of an equine heritage

IT IS late July in Galway, and there is not an empty hotel room or bar stool in sight. The annual Galway races, one of the top spots in the Irish social calendar, are also a big political occasion: the Fianna Fail tent at the races heaves with property developers and other campaign contributors. The races themselves often seem less important than the champagne (this is not the place for Guinness), the talk and the wheeling and dealing. Senior Fianna Fail ministers, among them Bertie Ahern, the taoiseach, spend whole days at the Galway races.

The presence of Fianna Fail's top brass reflects the party's populist roots as well as its need for money, but also something else: the importance of the horse in Ireland. The whole island stages over 300 race meetings a year, a 20% rise on a decade ago. Attendances have also gone up, by over 25% to some 1.4m. The green countryside of Ireland is now pleasantly pockmarked not just with racetracks but also with smart-looking stud farms.

But the business may not be quite as clean as it looks. There have been betting and race-fixing scandals over the years. Last November, Ireland's biggest stud-farm owner, John Magnier, hit the headlines when the manager of Manchester United football club, Sir Alex Ferguson, sued him over the stud earnings of a racehorse called “Rock of Gibraltar” in which he had been given a half-share. What made the case awkward was that Mr Magnier, with another rich Irishman, has a 29% stake in Manchester United.

But the biggest scandal is that super-rich stud-farm owners benefit shamelessly from an exemption from both income and corporate taxes. Ireland openly uses this exemption as an enticement to outsiders. Its share of Europe's thoroughbred stud industry has risen to over 40%, whereas Britain's has fallen sharply. The industry pleads that it contributes more to the Irish exchequer than the value of taxes forgone because it generates employment and wealth. But the European Commission is now investigating whether the tax exemption constitutes a form of illegal state aid.

Observers note two delicious ironies. One is that the EU single-market commissioner in charge of the investigation will be none other than the ex-finance minister, Charlie McCreevy, who is not only a dedicated race-goer but also gained notoriety for pouring public money into the struggling Punchestown racecourse, which happened to be in his constituency. The other is that Ireland's biggest foreign high-tech investment, the Intel plant at Leixlip near Dublin, was built on the site of a bankrupt stud farm.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

In place of strife

Oct 14th 2004
From The Economist print edition

Relative peace has been good for Northern Ireland's economy too

Getty Images

In the bad old days

BELFAST, like Dublin, has been transformed over the past 15 years. It used to be a bleak, partly bombed-out shell of a Victorian city, festooned with barbed wire and full of nervous soldiers in armoured vehicles. Now its centre is a bustling, lively place full of shops, offices, restaurants and theatres. Beyond the centre, admittedly, lie stark reminders of the province's sectarian tensions, most obviously the ugly graffiti-strewn walls that physically keep apart the divided Protestant and Catholic communities in the west and north. But overall Northern Ireland has changed sharply for the better—just like the republic.

The big difference is that the primary agent of change in Northern Ireland has been not economics but peace. The Irish Republican Army declared a ceasefire in 1994, after a 25-year campaign in which some 3,000 people were killed. That ceasefire has been mostly stuck to. The Good Friday agreement of April 1998 was later approved by referendums in both parts of the island. It led not only to the republic amending its constitution to drop its territorial claims on Northern Ireland but also to the restoration of devolved government at Belfast's Stormont. Sinn Fein, the IRA's political wing, joined in for the first time, with its former chief of staff, Martin McGuinness, somewhat incongruously serving as education minister.

Northern Ireland's devolved government has since been suspended several times, usually because Unionist parties wanted more progress in decommissioning IRA weapons. The most recent suspension, in October 2002, came after a scandal when Sinn Fein was found spying on Northern Ireland Office ministers and other parties at Stormont. Since then, attitudes across the divide have hardened.

In elections in 2003, the Catholic, nationalist vote shifted from the moderate Social and Democratic Labour Party (SDLP) to Sinn Fein, led by Gerry Adams. The Protestant, Unionist vote also moved, from the Ulster Unionists to the harder-line, anti-agreement, Democratic Unionist Party (DUP), led by Ian Paisley. The two (moderate) Nobel peace-prize winners, John Hume of the SDLP and David Trimble of the Ulster Unionists, have been sidelined (and Mr Hume has stood down).

This polarisation towards the extremes helps to explain the failure of the latest attempt to reach agreement on restoration of devolved government, at a summit meeting of the British and Irish governments and Northern Irish political leaders at Leeds Castle last month. But there are grounds for optimism, even for hoping for a total disarmament of the IRA. Nobody involved wants to go backwards to the years of the Troubles, when the IRA (and loyalist paramilitaries) were bombing and killing in both province and mainland. Moreover, it may, oddly, be easier to forge peace in Northern Ireland if the two

main protagonists represent the extremes of the sectarian divide.

Economics follows the peace

The unsung hero of the past decade in Northern Ireland has been the economy. Its performance has been a lot less spectacular than that of the Celtic Tiger next door, but Northern Ireland in the 1990s still grew faster than any other region in Britain. Growth has slowed in recent years, but unemployment is down to just over 5%, which puts it in the middle ground among British regions. Few would have predicted a decade ago that what was then the basket-case of the British economy would soon have lower unemployment than London, the west Midlands, the north-east and Scotland.

Yet there are also economic clouds hanging over Northern Ireland. Its manufacturing base continues to shrink, a change that matters more than in the republic because the six counties were always the most heavily industrialised part of the island. The linen, textile and shipbuilding industries are a shadow of their former selves (the cranes at Harland & Wolff, where the *Titanic* was built, now look down on a science park). Employment in manufacturing has fallen from almost 200,000 two decades ago to under 100,000 now.

Even more serious is the economy's dependence on the public sector. Philip McDonagh, chief economist at PricewaterhouseCoopers in Belfast, reckons that the public sector accounts for some 65% of GDP in Northern Ireland. That share has remained steady even as security and police spending has fallen, because public spending elsewhere has been expanding so fast. But that is unlikely to continue. In any case, the economy needs more private enterprise, and especially more high-technology, high-value-added businesses and, above all, services. Tourism, for instance, is feeble, contributing less than 4% of GDP, compared with about 6% in the republic and 7% in mainland Britain.

Partly because it is so big, the public sector is also inefficient. Schools do better than in mainland Britain, but health care needs rationalising. There are 26 district councils for a population of only 1.7m. Insiders reckon that the number could be shrunk to four or five, though that might be politically tricky. All efforts to trim employment in the civil or public services tend to generate fierce resistance.

Is an all-island economy in the making? One answer is that trade across the border remains underdeveloped. InterTrade Ireland, one of the six cross-border bodies set up after the Good Friday agreement, is trying to foster more. Over the past five years, the value of cross-border trade has doubled in real terms, says Liam Nellis, its chief executive. But one-third of it consists of food and live animals. Obstacles to greater all-island trade include currency, tax and infrastructure differences. Were Britain to join the euro, trade across the border might rise sharply. Yet the biggest problem, says Mr Nellis, is lack of knowledge and of personal contacts.

In the end, though, the fortunes of Northern Ireland depend most of all on a continuation of the peace process. Business surveys since the suspension of Stormont in October 2002 have been getting gloomier. For the most part, government and business are able to work quite happily without the assembly and devolved government. But so long as there is a question-mark over peace, some businessmen and foreign investors will hold back.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

A European country like any other

Oct 14th 2004
From The Economist print edition

Photocall Ireland

Ireland's economic success has helped its society to grow up

THE stereotype of Irish backwardness 30 or 40 years ago had much truth in it. The influence of the land was strong in a country where as late as 1973 one-quarter of the population was engaged in farming. In De Valera's time the Catholic Church's power was vast, and it lingered on into the 1980s. No politician could contemplate proposing a law without winning the approval of the Catholic hierarchy. Divorce, abortion and most forms of birth control were in effect illegal. Education was patchy at best: even into the 1960s, people had to pay for secondary schooling.

Irish society was also deeply patriarchal. Women were second-class citizens who were expected to stay at home and have babies. Many husbands would go abroad for long periods to work, and immigration was almost unknown. Ireland continued to define itself largely against Britain, by far its biggest trading partner and the recipient of most of its emigrants. The great famine of the 1840s proved an enduring influence.

But as the country has become richer over the past two decades, all this has changed. Divorce was legalised only in 1995 and abortion remains illegal in most circumstances, but Irish family life has evolved to look more like the rest of Europe's. The birth rate has tumbled, and many more married women are at work. The abortion rate is estimated to have risen from around 4.5% of pregnancies in 1980 to over 10% in 2002 (mostly carried out in Britain); over the same period, births out of wedlock have soared from 5% to 31% of the total. The divorce rate is creeping up.

Crime and violence are on the rise. Ireland has turned from a country of emigration into one of immigration, and although as many as one-third of the immigrants have Irish roots (or are former emigrants returning home), many now come from farther afield and look recognisably foreign in Dublin's streets. The country has also had a big influx of people from central and eastern Europe. In restaurants and bars, even in cities such as Cork and Galway, the staff often hail from such countries as Slovakia or (non-EU) Croatia.

As for religion, although almost 90% of the population still claim that they are Catholic, the Catholic Church is not the force it was. It fought hard against the legalisation of divorce, but lost decisively. It is hard to imagine the church in its heyday tolerating a taoiseach living with a woman who was not his wife, as Mr Ahern did for many years.

Like its counterpart in America, the Catholic Church in Ireland through the 1990s was beset by a series of sex scandals involving priests and boys, or children's homes run by religious orders. One bishop had to resign after seeming to cover up for abusive priests. Some 18 religious orders were landed with compensation bills that may reach €128m (though the state helped by taking on all additional liabilities).

The new Archbishop of Dublin, Diarmuid Martin, who recently returned to Ireland after long service abroad, concedes that the church has gone through difficult times, but insists that it is still one of the strongest in Europe. In many ways he welcomes “modernisation”: in particular, the ending of the church's long entanglement with politics. The archbishop sees a big role for the church in tackling Ireland's growing social problems: he notes more violence, more drug and alcohol abuse, and greater

selfishness than before he went abroad.

Yet the church suffers from long-term weaknesses. As with the Protestant Church of Ireland, which claims about 5% of the population, congregations and priests alike are ageing. Archbishop Martin recalls that when he was ordained in the diocese of Dublin in 1969, there were 13 other ordinands. Last year there was one. Next year, there will be none. The archbishop says he does not want to preside over a dying church; he talks ruefully of Catholicism becoming a “minority culture” in Ireland. In many ways, after years of sectarian conflict, religion now plays a bigger role north of the border.

It is not only churchmen who regret Ireland's growing secularism. David Quinn, a journalist at the daily *Irish Independent*, points to rising drug and alcohol consumption, a sharp increase in suicides, a greater incidence of sexually transmitted diseases and a growing “yob culture”. He suggests that with the decline of religion, society has lost a moral compass.

Yet Michael McDowell, the thoughtful Progressive Democrat justice minister, says it would be wrong to hanker after the good old days: “They weren't that good.” The social changes that attract criticism are common across Europe, he suggests. And curtailing people's liberties would be the wrong response. Admittedly, Ireland earlier this year became the first EU country to ban smoking in pubs and restaurants, but the government sees that as a health issue, not a matter of civil liberties.

Left-leaning commentators criticise the government for presiding over rising poverty and inequality. Much fuss was made over a recent UN report suggesting that Ireland had become more unequal during its tiger years, and was now one of the most unequal countries in Europe. The figures are a matter of dispute, but in any event Mr McDowell offers a robust defence. Fifteen years ago, he says, political conversation was about economic failure and poverty. Since then, absolute poverty has fallen sharply. He sees inequality as an inevitable part of the society of incentives that Ireland has, thankfully, become.

His party leader, Mary Harney, puts the emphasis on equality of opportunity, not equality per se. She also symbolises another huge change for the better in Ireland: its treatment of women. A generation ago they were second-class citizens. Now not only is the tanaiste female, but so is the president, Mary McAleese—as was her immediate predecessor, Mary Robinson. Far more women are working, and some are starting to rise to the top in business.

Looking which way?

What do all these social changes add up to? A few years ago, Ms Harney caused a stir with an address that became known as her Boston v Berlin speech. In it she claimed that, because its success was rooted in lower taxes and other free-market policies, Ireland, though geographically closer to Berlin, was spiritually closer to Boston. It is an appealing thesis.

Yet in social terms, the Boston v Berlin thesis looks wrong. In every area where Ireland has seen social change—secularisation, the growth of public health and welfare systems, trends in crime, drug and alcohol abuse, changing family patterns, increased migration—the shift has brought it closer to Europe than to America. By European standards the Irish tax burden is low, but it is still well above America's (see chart 5). Thanks to cheap flights (notably through Ryanair, a young airline that has made a big contribution to social change in Ireland), many more people travel from Ireland to Britain and continental Europe than go to America.

Indeed, in many ways the place that Ireland most resembles now is not America; it is Britain—but with a pro-European stance. Many British politicians think their country should become more detached from Europe, or even become more firmly attached to America. Yet in Ireland, despite Ms Harney's Boston v Berlin thesis, nobody would dream of suggesting such a move. Which is not to say that nationalist feeling is weaker than in Britain. The country's efforts to promote the Gaelic language belie that. Yet in practice as opposed to sentiment, Gaelic is still declining. When one minister was confronted by protesters demanding that Gaelic be made an official EU language, he went to talk to them—only to discover that they themselves did not speak the language.

As if to demonstrate its European credentials, Ireland is even metricating its road signs. Driving west of Cork, your correspondent spotted a sign reading: “Speed limit: 60km per hour for the next five miles.” Naturally, nobody took much notice. Ireland will surely retain its charms and foibles, though its growing tourist industry will not be helped by the ugly houses sprouting across open countryside or the salmon farms that jeopardise its glorious wild salmon and salmon-trout runs.

The point about Ireland is not that people have become rich, though many have. Nor is it that, in just ten years, it has undergone a modernisation and secularisation that took other countries several times as long, though it has. No, the really big thing is that, 30 years after joining Europe, Ireland has grown up. No longer does it suffer from a lack of confidence or excessive touchiness about Britain. Instead, it has become like any other well-off European country, with reasonable if not outstanding growth prospects and a recognisably European social mix. On the whole, this is a vast change for the better—even if some traditionalists may mourn it.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Acknowledgments

Oct 14th 2004
From The Economist print edition

As befits a literary nation, there is a vast literature on Ireland. This survey draws especially on "Modern Ireland 1600-1972" by R. F. Foster (Penguin), "The Transformation of Ireland 1900-2000" by Diarmaid Ferriter (Profile Books), "Reflections on the Irish State" by Garret FitzGerald (Irish Academic Press), "The Making of the Celtic Tiger" by Ray MacSharry and Padraic White (Mercier Press), "Breaking the Bonds: Making Peace in Northern Ireland" by Fionnuala O'Connor (Mainstream), the OECD's July 2003 survey of Ireland and "Catching Up With The Leaders" by Patrick Honohan and Brendan Walsh (Brookings Papers on Economic Activity, 2002). The author would like to thank all those who generously made themselves available for interview, not all of whom are cited in the text.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Offer to readers

Oct 14th 2004
From The Economist print edition

Buy a PDF of this complete survey, including all graphics, for saving or one-click printing for $4.95.

Reprints of this survey are available at a price of £2.50 plus postage and packing.

A minimum order of five copies is required.

Send orders to:

The Economist Shop
15 Regent Street, London SW1Y 4LR
Tel +44 (0)20 7839 1937
Fax +44 (0)20 7839 1921
e-mail: shop@economist.com

Corporate offer

For corporate orders of 500 or more and customisation options, please contact the Rights and Syndication Department on:

Tel +44 (0)20 7830 7000
Fax +44 (0)20 7830 7135
or e-mail: rights@economist.com

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Chief executives

Passing the baton

Oct 14th 2004
From The Economist print edition

It is rarely a good idea to appoint an outsider as the company's new boss

PATRICK CESCAU is settling into his new job as the head of Unilever having taken over from Niall Fitzgerald. The transition was smooth: when Mr Fitzgerald took the post he said he would hold it for eight years, and his eight years are up. In February, he said Mr Cescau, a 30-year veteran of the Anglo-Dutch multinational and then head of its foods division, would be the next chairman, and from April Mr Cescau shadowed Mr Fitzgerald on the job. In another well-planned move, Mr Fitzgerald is not hanging around to watch over the new man's shoulder. On October 1st he became non-executive chairman of Reuters, the news organisation, a role he is combining with a clutch of other appointments outside Unilever.

These careful steps are a sharp contrast to the uncertainty over succession at many other companies. This week, after the sudden withdrawal from the market because of health fears of its painkiller Vioxx, it emerged that Merck had begun looking for an outsider as a possible replacement for its chief executive, Raymond Gilmartin, who is due to retire in 2006. While an internal candidate might yet be appointed, the widening of the competition for the top job adds a new level of unpredictability to the future of the American drugmaker.

This could be made worse if the search drags on, like the long-drawn-out affair at Walt Disney. There Michael Eisner, its deeply entrenched boss, was forced to give up the chairmanship by dissatisfied shareholders in March and has said he will step down as CEO when his contract ends in September 2006. As with the recent pronouncement by Tony Blair that he will not be Britain's prime minister beyond a third term, the timing of his departure may not be entirely his to determine. George Mitchell, Disney's current chairman, has been quoted as saying that Mr Eisner “will continue to be the chief executive officer until such time as the board determines it is appropriate for the new CEO to take office”.

There is intense speculation about who that might be. Among the possibilities are Mr Eisner's personal favourite, Robert Iger, currently Disney's chief operating officer, and Terry Semel, the boss of Yahoo!.

An inside job

What is the best way to replace the boss? A recent study of large, non-diversified publicly traded

American manufacturing firms in the *Academy of Management Journal* suggests that companies perform better under a new leader if that person has been groomed as the heir apparent—what it calls “relay succession”. The grooming period, say the authors, Nandini Rajagopalan and Yan Zhang, professors at the University of Southern California and Rice University respectively, is “akin to a school, within which a new CEO's education takes place”. They found that, other things being equal, relay succession produces a significantly better financial performance than the alternatives—selecting an outsider, who inevitably lacks knowledge of the firm, or holding a competition between internal candidates.

But boards must do more than draw up a list of high-potential employees to plan an internal succession, argues a new report from A.T. Kearney. The management-consulting firm says one of its clients uses a talent-management programme that includes evaluation, mentoring and individual development plans for its high-flyers. “With business units often larger in size than some countries' economies, and business complexity that requires continuity to sustain and grow shareholder value, more boards are making enterprise-wide succession plans,” claims the report.

Companies feel the need to turn to outsiders most strongly when they are underperforming. But unpublished analysis by Marakon, a consultancy, of transitions over the past decade at the top of Britain's biggest quoted companies shows that internal appointees have been slightly more successful at turning round underperforming firms than outsiders, confirming the findings of Ms Rajagopalan and Ms Zhang. In fact, they found that struggling companies (other than those in “unstable industries”, such as computers and toys) gained even more from relay succession than did companies that were doing well. So if Disney, whose recent performance has been far from stellar, takes note of these findings, it ought to hand the baton to an internal candidate sooner rather than later.

And yet relying mostly on internal candidates can carry risks. In Disney's case, the company's problem is that the board, while appointing headhunters to trawl outside for a new boss, has said that Mr Iger is the only internal candidate, and a significant group of shareholders, incensed by Mr Eisner's high-handed ways, are threatening to challenge anyone they feel he is trying to foist upon them.

The cost of holding a competition for the job among internal candidates seemed most apparent when General Electric chose Jack Welch's successor by means of a three-horse race. The winner, Jeffrey Immelt, was announced in November 2000. In little more than a week, the two losing candidates had been lured away by big prestigious companies; James McNerney to 3M and Robert Nardelli to Home Depot. Their immediate loss was a high price to pay for holding a competition.

Even when succession planning works triumphantly, however, it can be undermined by accidents. McDonald's boss, Jim Cantalupo, (see article) died of a heart attack in April this year while attending a company convention. Within hours the board had replaced him with their pre-agreed successor: Charlie Bell, a 43-year-old Australian. But Mr Bell almost immediately had to undergo surgery for cancer from which he has not yet fully recovered.

In November last year, Boeing had to sack its heir apparent, Mike Sears, when he was found to have offered a job to someone in the procurement department of the Pentagon. When the CEO, Phil Condit, was forced to resign soon after, the company had to call on 67-year-old Harry Stonecipher, a retired Boeing executive.

Unforeseen events and accidents aside, the evidence is now strongly in favour of the appointment of internal candidates to succeed the departing chief executives of big companies. This should mean that boards which turn to outsiders should have to give shareholders compelling arguments for doing so.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Retailing

On Target

Oct 14th 2004 | CHICAGO
From The Economist print edition

How to be upmarket and downmarket at the same time

AP

Get rid of the Jaguar, we need an SUV

CALL it cheap chic or class for the masses, whatever it is the appeal of trendy goods at low prices has enabled America's Target to grow rapidly in a part of the retail market that many fear to tread. Now Target is trying new ways to remain both upmarket and downmarket at the same time, just as some wonder if it will try to take its strategy overseas, perhaps with a foreign takeover?

With more than 1,200 stores in 47 states, Target has already expanded far from its roots in America's mid-west. Its trademark red-and-white logo of a bull's eye is increasingly in the sights of envious competitors at home and retailers abroad, who are curious to know how it has become the store of choice for a growing number of Americans, including many who could afford to shop elsewhere.

Target had sales of $41 billion last year, up from $32 billion in 2001, which makes it second only to Wal-Mart in America as a mass merchandiser, even though it is a quarter of Wal-Mart's size. The niche that Target has carved out for itself is as a classy low-cost alternative to pile-it-high superstores, especially for customers who would not be caught dead in a Wal-Mart.

Indeed, the typical Target shopper has a family income over $50,000 a year, says Sherif Mityas, a retail expert at consultants A.T. Kearney, compared with that of about $30,000 a year for a typical Wal-Mart shopper. This is noticeable in the car park at the SuperTarget on Chicago's north side: the customers are a mix of families and young professionals loading up their sport-utility vehicles with everything from Mossimo clothing to six-packs of Target's own-brand toilet paper. “In a Wal-Mart parking lot you're not seeing the Jaguars and Mercedes,” notes Mr Mityas.

Target offers a wide range of items, from jeans and toys to sporting goods and consumer electronics. It does this by taking special lines, such as Isaac Mizrahi's women's clothing, and by commissioning designers to produce own-brand items. These are sold along with staples such as tissues and cereal.

The mix includes more apparel than Wal-Mart, says Bill Dreher, an analyst with Deutsche Bank. An unusually high 80% of Target's clothing is private label (Target owns a company that specialises in sourcing clothing and product development). Stylish advertising is then applied. This summer, in a dash of marketing chutzpah, Target set up a temporary “pop-up” shop at the Bullseye Inn in swanky Bridgehampton, New York, to sell discount table linens and clothes to Manhattanites on holiday.

The first Target opened in 1962 in Roseville, Minnesota—the same year that Wal-Mart and Kmart, which now trails in third place, got into the business. The firm evolved from Dayton department stores in Minneapolis, where Target is based. Euromonitor, a market research firm, reckons that Target's sales per square foot last year were $243 compared with Wal-Mart's $435, which indicates its efforts to provide a less-cluttered atmosphere in its stores. Yet both chains showed same-store sales up 4% from the year earlier. Kmart's sales, meanwhile, fell by 8%.

While the typical Target store averages 126,000 square feet (11,706 square metres), it is building bigger ones called Greatlands and SuperTargets (essentially Greatlands with more food). These can reach a colossal 175,000 square feet. This year the company sold its Marshall Field's department stores and Mervyn's, a mid-market store chain, for over $4 billion.

The company intends to use some of this money to keep innovating. A Target in central Minneapolis offers one glimpse of the future: the two-level store has an escalator which allows people to take their shopping carts with them. This format can be used to occupy urban retail sites, just as some local communities are starting to object to the building of more edge-of-town “big box” retail units.

Target was also one of the founders of the WorldWide Retail Exchange, which was set up in 2000 as an internet business-to-business marketplace. The exchange is run as an independent company that allows its more than 60 members to compete against the proprietary online trading system used by Wal-Mart and its suppliers.

Target's cash pile and success have fuelled rumours of international expansion. But some analysts question whether Target's model would work well outside America, with the possible exception of Canada or Mexico. Retailing styles sometimes do not travel well: Wal-Mart fell on its face in Germany, and this week France's Carrefour, the inventor of the hypermarket, was rumoured to be on the verge of quitting Japan after its struggles to enter the market there.

Target will not discuss its international ambitions, although it has previously denied reports that it was contemplating a bid for Sainsbury's, a struggling British supermarket chain. Perhaps Sainsbury's, which this week issued a profits warning, is too far gone to be an attractive acquisition. So, Target may just decide to stay at home for a while longer. After all, its growth opportunities in America remain appealing, particularly on the east coast, where it still has relatively few stores.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Craigslist

Honouring nerd values

Oct 14th 2004 | SAN FRANCISCO
From The Economist print edition

An online phenomenon becomes an official one

Gene X Hwang-Orange Photography

IT WAS officially “Craigslist day” in San Francisco on October 10th. But even Craig Newmark—he of the list—had to admit that “not terribly much happened”. Still, there was a good party and a documentary was screened on how craigslist.org, a plain but packed online bulletin board, has transformed the lives of many inhabitants of California's Bay Area since it started in 1995.

“Some people assemble their entire lives on our site,” says Mr Newmark, like a proud father. Indeed there are San Franciscans who have found their spouse, job, house and pet on Craigslist. The top two categories among its 3m classified ads in any given month are for job vacancies (23%) and accommodation (21%). And then there is everything else. The lady, for instance, who found solace among other owners of diabetic cats. Or the gay amateur porn star who seeks customers for his full-service massages. Flash mobs are big, and all events in general.

With 1 billion page views a month, mostly from the Bay Area and New York, this is the sort of success that most dotcoms can only dream about. What is the secret? “Our main purpose is to be a public service,” says Jim Buckmaster, whom Mr Newmark brought in as chief executive in 2000 (the division of labour being that “Jim does everything that requires being tall, while I stand on a stool in pictures,” says Mr Newmark, who is constitutionally unable to speak without humour). Craigslist is officially registered as a for-profit company and it does make money. But, says Mr Buckmaster, “the org indicates intent, in the sense that we're like a commons in medieval England.”

Mr Buckmaster and Mr Newmark say these things with total credibility. A deciding moment occurred in 1997, when Microsoft offered a lot of money to place banner ads on the site. Mr Newmark thought about it for a nanosecond, then turned the offer down. Instead, all the money—he will not say how much—still comes exclusively from employers advertising job vacancies; they represent less than 0.1% of all users. For everyone else, Craigslist is free. This generates, even if it sounds sappy, a genuine sense of community.

Craigslist is now spreading to other cities. There was no formal decision to go global. Instead, Mr Newmark and Mr Buckmaster read e-mails from San Franciscans who moved to Anchorage or Edinburgh and whined because there were no Craigslists there. Starting a site for a new city is easy and essentially cost-free, says Mr Buckmaster, since all they do is provide a web page and some rules. The new community then builds itself from the ground up. Thus Craigslist is now in 57 cities and five countries, but has only 14 employees working out of a flat in San Francisco.

“We don't think of ourselves as a brand,” says Mr Buckmaster. Nevertheless many of the big and more commercially minded dotcoms have had their eye on Craigslist for a while. Recently eBay, the world's biggest online-auction site, got to the front of the queue and grabbed a 25% stake when a Craigslist shareholder sold out. Not for the money, mind you. “For us, it's about learning,” says Hani Durzy, an eBay spokesman.

For Mr Newmark, the thing to understand is really quite simple. He is a nerd, he is proud to say, and thus exhibits “the same dysfunction as my nerd brethren”. Ultimately, this comes down to steadfastly following “nerd values: once you make enough money, it's time to improve the world”. His home town

loves and honours him for it.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Textiles

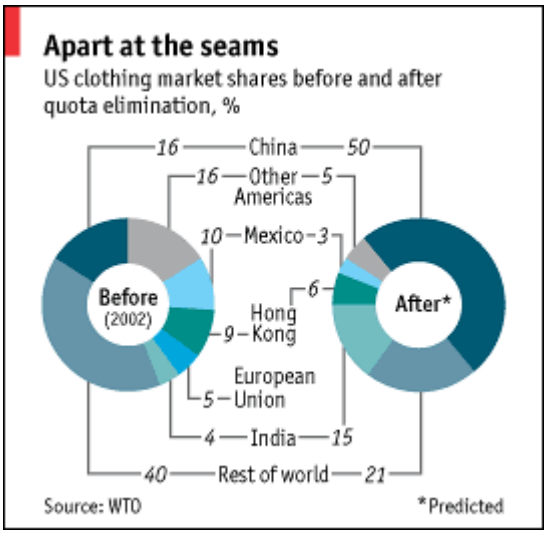
Losing their shirts

Oct 14th 2004 | AGUASCALIENTES, MEXICO
From The Economist print edition

Central America and the Caribbean face an onslaught from rivals

THE biggest transformation in a generation of the world's textile and clothing industries will begin on January 1st 2005, when more than 40 years of import quotas will come to an end as the result of a longstanding deal under global trade rules. As retailers are set free to buy what they want from wherever they want, the consequences for countries with labour-intensive industries that rely on making garments will be huge. Most suppliers will be watching closely what happens in the biggest market of all, the United States—and none more so than textile firms in nearby Central America and the Caribbean.

The World Trade Organisation (WTO) recently made its own predictions of what the post-quota world may look like. While modest changes are expected in Europe, the American market will be transformed. In textiles, China's market-share of imports to the United States is expected to rise from 11% to 18%, while its share of made-up clothing leaps from 16% to 50%. India looks set to become the second-biggest supplier to America, with its share bouncing from 4% to 15%. While this is good news for Asia, the WTO expects many of America's traditional suppliers to be hit hard. Mexico's market share in clothing imports to the US could decline by 70%, to give it a market share of just 3%, with similar steep falls in imports from other countries (see chart).



This means there will be a lot of excess capacity, which is creating fears of widespread job losses. Moreover, as the regional clothing and textile industries are grouped in clusters, the local pain will be intense. Honduras in Central America and the Dominican Republic in the Caribbean are, along with Mexico, the main centres of clothing “assembly for export”, or *maquiladora*. By volume, Honduras is the third-largest exporter of clothes to America. Its economy and that of the Dominican Republic are particularly reliant on textiles and clothing, and almost all their output goes to the United States. In the Dominican Republic, textile and clothing accounts for about 150,000 of the country's 200,000 assembly jobs. This poses grave consequences for small, fragile economies.

Labour costs are the biggest area of concern. Carlos Lopez Perez is president of the local textile chamber in the Mexican city of Aguascalientes, which is home to one of the country's biggest clusters. He says the wages paid by his members are about three times as high as in China. Cheaper Chinese imports have already swamped Mexico's own domestic market to such an extent that Mexico has had a trade deficit in textiles since 1999.

If textile manufacturers in Central America and the Caribbean are unable to compete on price, how will they survive? The consensus is that they must take more advantage of being close to the United States. For that they find solace in today's world of fashion-sensitive lean retailing, in which speed to market matters most and shops restock more regularly. Raymond Haché, sales director of InterAmericana, a big Dominican exporter, argues that if an American retailer wants a new line, his firm can develop and produce it in 45-60 days—and ship it to an American port in 40 hours. The Chinese, he argues, would take three months to develop the new line and 30 days to ship it.

Yet to deliver a just-in-time service, the region's suppliers must be more flexible. Mr Haché argues that to meet the Chinese challenge, his company has already invested in five flexible production lines that can

switch from one product to another on a daily basis to meet demand. Fashion no longer has to be expensive. For brands like Tommy Hilfiger and Zara, he says, orders will go to suppliers who “can be flexible with trends in quite inexpensive items”.

The other key to survival, argues Henry Fransen, director of the Honduran Manufacturers Association, is the ability to deliver a full package of services. As retailers no longer have to source from many different countries, they will be looking to single suppliers to do everything from design to cutting and assembly. This will smooth and expedite their supply chains. Thus there will be a new premium on skilled labour, as companies have to extend their range of skills from just sewing and stitching. A Central American free-trade agreement, awaiting ratification by the US Congress, may also help.

But firms have to move quickly. The more far-sighted companies, like InterAmericana, have already invested in the changes. Other clusters are quickly trying to catch up. The manufacturers around San Pedro Sula in Honduras are combining to set up a new technical school to help them produce a wider range of services.

But these places may be the exception. In Mexico, Mr Perez bears out the gloomy WTO prediction for his country, acknowledging that there is “little awareness of the changes going on”. Moreover, it is often only the bigger companies that have the financial resources to change to just-in-time production systems and offer a full package of services. About a quarter of Mexico's textile industry is made up of tiny businesses with 100 employees or less. For them, the new year could be very grim.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Steel

Samba school

Oct 14th 2004
From The Economist print edition

Brazil leads a dance to become very big in steel

AP

IF IT all goes ahead, the result will be a new steel centre of global proportions. Brazil's Companhia Vale do Rio Doce (CVRD) is the world's biggest producer of iron ore and pellets. But it is willing to go downstream to help its main business. Although in June the company agreed to sell its 28% stake in CST, Brazil's third-biggest steelmaker, it is now talking to foreign giants about partnerships to build three steel plants on Brazil's northern coast, with a combined output that could, in time, total a massive 24m tonnes a year.

That figure is some two-thirds of Brazil's present steel output and over half of Germany's. No less important, for Brazilians, it would be a big step towards keeping the potential value-added of Brazil's vast natural resources inside the country—a dream of many developing nations, but one that few have achieved. Brazil's national development bank is already on side to shoulder a third of the possible $11.5-billion cost of this ambitious project.

Will it all happen? CVRD's talks have gone furthest with Baosteel, a huge, partly privatised Chinese steelmaker. With China expected to import 45m of the 300m tonnes of steel it may use this year, Baosteel's interest is easily explained. But it has yet to decide whether to make steel in Brazil or just import ore to process at home.

Posco, from South Korea, the world's fourth-largest steelmaker, is in talks about a separate plant. But it has already announced plans for a steelworks in eastern India, in collaboration with the Anglo-Australian mining giant BHP Billiton. Posco too has big ambitions: expecting to produce 30m tonnes of steel this year, it dreams of 50m within ten years' time. This week, Posco revealed third-quarter profits doubled to $875m, but could it afford a big expansion in India and Brazil at the same time? Some Indians fear it may switch to Brazil. That would be embarrassing, however, not only for Posco but for the South Korean government, which has publicly backed the Indian project.

Who could be CVRD's third partner? A port in northern Brazil would be well placed to serve either North America or Europe. But Brazil's steelmakers have had bitter experience of the American readiness to slap on tariffs, and they and their government might well prefer to look to Europe both for a market and a partner.

Who? Luxembourg-based Arcelor, the world's biggest steel producer, is eager to switch manufacturing capacity from Europe to cheaper regions. CVRD has close links with Arcelor. But it was Arcelor that bought CVRD's shares in CST, giving it control of that company; and it has stakes in other Brazilian steelmakers. Would it want a new commitment there?

Anglo-Dutch Corus is another possibility. In 2002 it announced plans for a takeover of CSN, CST's neck-and-neck rival. Within months the plan collapsed, as Corus itself almost did. Corus now has new bosses, but still no plant in Brazil. CSN has the attraction of owning a large ore mine. But a north-coast site would be usefully closer to Europe, Corus's main market, than is CSN's base near Rio de Janeiro.

But there is a cautionary thought. World steel output was 8.5% higher in the first eight months of this year compared with the same period last year. China's output was up by 21%—adding an extra 30m

tonnes in that country alone. But China's rate of growth may be slowing. Steelmakers know well what used to be called the “pig cycle”—about animals, not iron. When pork and bacon prices are high, lots of farmers rush into pigs, then lose their shirts as all their new output hits the market and prices crash. Steel is like that.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Face value

The way of the Warrior

Oct 14th 2004
From The Economist print edition

Padmasree Warrior, Motorola's technology chief, is trying to turn the company's new strategy into reality

Get article background

AS PADMASREE WARRIOR tells it, Motorola's new strategy materialised out of thin air during a transatlantic flight in February. Ms Warrior, the firm's chief technology officer, was on her way to an industry conference in Cannes with her boss, Ed Zander, who had taken over the previous month and was due to give a presentation. His slides, they concluded, were “kind of content-free”, says Ms Warrior candidly. They began discussing what Mr Zander ought to be saying about the future direction of the world's second-largest maker of mobile phones. This was more than just a matter of presentation: Mr Zander had just taken the helm of a sprawling company racked by internal strife and strategic paralysis, and everyone wanted to know what he planned to do. Would he spin off smaller divisions and concentrate, Nokia-like, on phones? Would he retreat from handsets and focus on network equipment, as Ericsson had done? Or would he try to capitalise, like Samsung, on the convergence between communications and entertainment?

By the time their plane landed, Mr Zander and Ms Warrior had cooked up the notion of “seamless mobility”. The idea was fine-tuned over the following months and was formally launched in July, and now underpins the way Mr Zander is running Motorola. The basic idea is both technology-driven, as you would expect from a company with a strong engineering tradition, and user-centric. As wireless, wireline and multimedia technologies proliferate, Motorola believes it is in a unique position to “bring simplicity to complexity” by tying everything together through the mobile handset (which Motorolans prefer to call “the device formerly known as the cell phone”).

Just as mobile phones already let you talk anywhere, says Ms Warrior, seamless mobility will let you do everything everywhere. “All the pieces we have fit into that architecture,” she says. Although mobile phones account for 40% of the company's revenues, Motorola also makes everything from automotive electronics and home-theatre equipment to emergency radios and mobile-phone base-stations. Seamless mobility provides a rationale for staying in all those markets, and turns the firm's diversity from a liability into an asset. Motorola says it is uniquely positioned to smooth the transition between home, work, automotive and mobile environments, providing high-speed internet access on trains, for example, e-mail in cars, video on phones, or mobile-phone coverage on planes.

Ms Warrior is the ideal ambassador for this new vision, and not simply because she co-invented it. She

leads Motorola's army of 4,600 technologists and marshals a $3.7 billion research budget, but her fearsome-sounding surname is at odds with her grace and charm. As an engineering graduate with a 20-year history at Motorola, she embodies both the technology-driven heritage of the old Motorola and the company's new, more friendly, user-driven approach. Seamless mobility is a very different approach to that being taken by Nokia, Ericsson or Samsung, she insists, since it is defined not by equipment or industrial structure, but by ease of use.

Anyone who has struggled with one of Motorola's notoriously complicated phones may find this hard to swallow, however. The firm is renowned for putting technology before simplicity. But that is changing, argues Ms Warrior. Motorola's range of camera-phones, known as the “triplets”, are both better looking and less fiddly than previous Motorola handsets, and have been stealing sales from Nokia, the market leader. Motorola's latest handset, a slimline phone called the Razr V3, has also gone down well. Is it a triumph of engineering, design or marketing? All three, which shows that Motorola has changed, says Ms Warrior. She has even moved engineering and marketing teams into the same offices to encourage them to work together.

Even if Motorola can make its devices easier to use, however, doesn't its vision force customers, Microsoft-like, to buy everything from one company? No, says Ms Warrior. The firm cannot do everything, and strikes partnerships where appropriate: a recent deal puts Apple's iTunes Music Store on to Motorola's mobile phones. Similarly, Motorola has a partnership with Microsoft to ensure connectivity with PCs, and this week announced a mobile-payments initiative with MasterCard.

Seamless communicating

Another criticism of the new strategy is that it merely provides a justification for leaving things as they are. But the goal of making things seamless is also being applied to Motorola itself. The company's sprawling divisions used to be run as separate firms, each with its own strategy team, computer systems, personnel department and procurement processes. The plan is now to make Motorola seamless on the inside, by ending such duplication; Ms Warrior is, for her part, imposing technology standards across the company. She is also doing away with duplication in research and development: the same camera technology used in mobile phones can, she says, also be used in car safety sensors to detect drifting out of lane, for example.

It is, however, too soon to say whether the new strategy is working, despite the dramatic improvement in Motorola's fortunes since Mr Zander's arrival. The triplets might simply have been a fluke, appearing as they did just as Nokia stumbled. And in the past, Motorola has occasionally articulated a seemingly coherent strategy, only to fail to deliver. The question, say industry analysts, is whether the vision of seamless mobility can provide more than just an umbrella to justify Motorola's sprawl. The next few months will reveal whether Motorola really can be both engineering-heavy and customer-centric—a combination to which many firms aspire, but few manage to achieve. Having helped Mr Zander devise a new vision for the company, Ms Warrior must now help him implement it.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

McDonald's turned around

Big Mac's makeover

Oct 14th 2004 | OAK BROOK, ILLINOIS
From The Economist print edition

The world's biggest fast-food company has pulled off a remarkable comeback

Get article background

AP

American icon

IN THE entrance to Hamburger University, the ultra-modern training centre for the world's biggest fast-food operation, Ray Kroc's office has been faithfully reassembled. McDonald's managers have looked to their late founder quite a bit lately for inspiration in how to deal with a series of crises, any one of which would have destroyed many companies. Mr Kroc used to say he didn't know what McDonald's would sell in the future, except that the company would sell the most of whatever it was. Remarkably, McDonald's has turned itself into the world's biggest seller of salads and its business is flourishing again. Yet despite all of its new lettuce, free-range eggs, bottled water and yoghurt parfaits, success remains, at least for now, all about burgers.

The company reached a low point in 2001, when customer-satisfaction surveys showed McDonald's was falling well behind its direct rivals, Wendy's and Burger King. Customers were also switching to healthier offerings, such as Subway's freshly filled sandwiches. Lots of money was spent opening yet more stores, but margins were shrinking and complaints about dirty restaurants and indifferent staff were growing. The firm's philosophy of QSC&V—quality, service, cleanliness and value—just was not working any more. McDonald's ended 2002 with its first quarterly loss since 1954, the year Mr Kroc persuaded the McDonald brothers to let him franchise their new “Speedee” self-service restaurant system.

McDonald's had lost more than direction. A wave of anti-American feeling abroad turned its world famous “golden arches” from an asset into a liability. And there was growing concern about obesity and junk food. McDonald's was even sued (so far, unsuccessfully) for making people fat. Even now, long after its debut in America, Morgan Spurlock's film “Super Size Me” is making overseas audiences cringe at how he made himself ill and gained 25 pounds (11kg) by eating only McDonald's food for 30 days.

Many companies might have tried to muddle through. But in January 2003, Jim Cantalupo, a McDonald's veteran who used to head international operations and who had been passed over for the top job, was brought back from retirement to replace Jack Greenberg, forced out as chief executive by worried shareholders. The “Plan to Win”, as the company's recovery strategy is called, is largely Mr Cantalupo's work. He was hugely popular at the firm's headquarters in a leafy Chicago suburb. However, in April, while attending a McDonald's convention in Florida, Mr Cantalupo, who was 60, died after a heart attack.

A lot of businesses would have been thrown into chaos by the loss of their leader at such a time. But McDonald's swiftly executed a succession strategy already in place. Within hours, Charlie Bell, a 43-year-old Australian promoted by Mr Cantalupo to chief operating officer, was addressing the troops as the first non-American to head the company. Yet the health scares remain. Mr Bell was diagnosed with cancer in May. Even while recovering from treatment, he has been determined to remain at the helm.

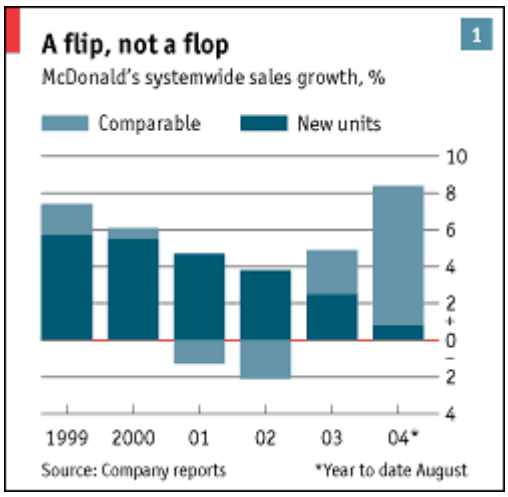
Fat, dumb, not happy

Mr Bell, who joined the company as a 15-year-old restaurant worker (a “crew member”, as McDonald's

calls them), is characteristically blunt about what went wrong. There are a lot of companies, he says, that “get fat, dumb and happy and take their eye off the ball.” People thought McDonald's was no longer capable of impressive results, he says. Yet for the first half of this year sales were up 13% to $9.1 billion, and net profits rose 38% to $1.1 billion, compared with the same period a year earlier. On October 13th McDonald's announced stunning third-quarter preliminary results. Its earnings per share jumped by 42% and sales again grew strongly. Much of McDonald's growth, though, has come from America: Europe has not yet shown a decisive turn for the better.

Measured by sales, McDonald's is about twice as big as its next global competitor, Yum! Brands, operator of Kentucky Fried Chicken (KFC), Pizza Hut and Taco Bell (although McDonald's operates slightly fewer restaurants). McDonald's makes its money from its 9,000 company-owned restaurants and the rent and service fees paid by franchisees and licence holders, who operate a further 22,000. A study by Citigroup Smith Barney reckons the average franchisee expects annual sales of about $1.7m from a restaurant and an operating profit of almost $150,000. This, it believes, could grow now that McDonald's is concentrating on expanding sales in existing restaurants.

Instead of opening lots of new restaurants, McDonald's has switched to generating more sales from its existing ones. This year, some 90% of McDonald's growth is likely to come from incremental sales at its existing restaurants, compared with around half last year (see chart 1). Last year, its restaurants worldwide generated an additional $400m to take annual positive cashflow to $3.3 billion. In September, McDonald's said it would use its cash pile to boost its annual dividend for the second consecutive year, pay down $600m-700m in debt and spend up to $1.6 billion opening some new restaurants (often in places like China), but mostly in doing up its existing ones.



Back to basics

Cleaner, smarter restaurants will help, but it is notoriously difficult to impose and then reinforce standardised operating procedures through a highly decentralised business—part of the problem when standards were falling. New technology will make things easier. Every McDonald's has a “travel path” along which a member of staff must walk—sometimes every 30 minutes—to ensure that all is well. The company is now testing small hand-held devices, which can be used like electronic clip-boards by those making the rounds. Failures to check, say, the temperature inside a refrigerator (the devices are fitted with a probe) or to scan a location barcode (they have a scanner too) when checking the play area, will be recorded. If too many incomplete checks build up, the device can automatically alert the local manager by ringing his mobile phone.

This might sound Big Brotherish, but McDonald's insists that its businesses will remain, in effect, lots of local restaurants, although ones expected to operate within clearly defined parameters. That still allows for plenty of variation. In some Latin American cities, McDonald's is even experimenting with differential pricing: charging different prices for meals according to the relative wealth of their neighbourhoods. “If you are looking for a command centre with one push button that operates our restaurants in every corner of the world, you won't find it,” says Jim Skinner, McDonald's vice-chairman.

And like any local restaurant, it is what is on the menu that is really important. The average sale in a McDonald's is just under $5. Typically what might happen is a mother comes in, buys her children a Happy Meal, and herself just a coffee. Now that salads and other lighter options have been added to the menu, many of those mothers now buy themselves a meal too, lifting the order value to around $12. The lighter options also encourage existing customers to come back more often because there is a greater variety of things to eat. Nevertheless, for now, the Big Mac remains the most popular item worldwide.

McDonald's does not publicly break down sales and profits of its individual items. But anything that involves fresh, perishable produce that does not come in a standardised and easily storable form (ie, a lettuce compared with a frozen hamburger patty), increases complexity and cost. McDonald's officials insist their salads are priced to be profitable, arguing that if they were not its franchisees would not want to sell them. But then, by some measures, supermarket loss-leaders are also profitable because they bring in customers who buy other products. Nevertheless, salads are sending a message to millions of customers: that it is now acceptable to eat at McDonald's again because the menu is “healthier”—even though the vast majority still order a burger and fries.

“There is no question that we make more money from selling hamburgers and cheeseburgers,” says Matthew Paull, McDonald's chief financial officer. Sales growth is, he says, being driven by the “halo effect” of healthier food appearing on the menu. He expects that will continue. Beyond 2005 he reckons sales will grow 3-5% a year, and the return on the company's investments in new and remodelled restaurants to be in the “high teens”. There will also be more new items appearing on the menu.

What's cooking?

The future of fast food is being cooked-up in an anonymous warehouse sitting among many others on a vast distribution park on the plains of Illinois. This is McDonald's Innovation Centre. Inside are several fully functioning restaurants. As staff prepare and cook meals, others act as customers. Any one of the more than 31,000 McDonald's can be replicated here. Despite the common perception that they are clones, there are plenty of differences—especially on a regional level. The fruit servings that McDonald's is starting to offer its customers illustrate this: there are packets of skinned apple-slices for the Americans, but the skins are left on for Europeans. The Australians, meanwhile, just get an apple. Local tastes and preferences, says a chief, count for a lot.

At a busy replica of a British restaurant, video cameras record a time-and-motion study. Moving the relish dispensers could mean a crew member in the food preparation area no longer has to make a half turn. That could save a second or so, which means a customer gets his burger faster. But will it cause problems elsewhere in the system? Nobody, as Mr Kroc used to say, takes hamburgers more seriously.

Yet the really interesting thing going on here is at a hybrid restaurant, which in part uses McDonald's Japanese system—creator of the Teriyaki burger—and a new concept from Sweden, which grills burgers vertically instead of horizontally as on a traditional griddle. This new type of grill offers great space-saving possibilities—extremely useful in crowded Japan. But it is what is on the menu that, for McDonald's at least, is truly revolutionary.

Among half-a-dozen choices are a “New York Reuben”, a “Grilled Veggie” and a “Leaning Tower Italian”. As in any experimental facility, McDonald's stresses that not all the ideas being worked on here will make it to market. But the signs are that McDonald's is getting serious about sandwiches. Their experimental “Oven Selects” range, freshly made and toasted to order, is now going on trial at some 400 restaurants in America. If the sandwiches, which will sell for $4 each (relatively expensive for McDonald's), are a hit, they could become a global product.

Moving into the sandwich business means that McDonald's will compete more directly with the likes of chains such as Subway, and against countless corner delis and supermarkets. “Sandwiches outsell hamburgers by ten to one,” says Russ Smyth, president of McDonald's Europe. “So there is a great opportunity here.” In order to grow the business in some of its mature markets, McDonald's has to take market share from others. In Europe, says Mr Smyth, the so-called “informal eating-out market” has been declining, but McDonald's has lately managed to boost its share from 11% to 12%.

Sandwiches are not the only innovation in the works. The Australian market pioneered gourmet coffee for its customers. This has been developed into a concept called McCafé, which is already providing coffee lounges inside 500 existing McDonald's restaurants. Some of these are being fitted out as wireless hot spots for the internet. But can McDonald's really hope to take on Starbucks too?

It will be a challenge for the company to manage a multi-format operation under one brand, says Jim Farrell. He has followed McDonald's closely since working there as a teenager and later in his career as a management consultant based in Chicago. Having a bigger variety of items on the menu means more potential problems and higher costs. It also means trying to appeal to one group of customers without alienating another. For instance, says Mr Farrell, a restaurant that is attractive to families and is full of children clamouring for Happy Meals (or the toys in them) might not appeal to stressed-out office workers who have popped out for a quick sandwich and coffee.

Hot in the kitchen

McDonald's could try to become different things in different locations, and at different times: it is already trying harder to catch the breakfast trade. Mr Farrell suggests another way could be a cluster of operations in which a coffee bar, fast-food outlet and sandwich counter share adjacent parts of the same building—a bit like a food court.

Yum! Brands already does this by grouping some of its restaurants together to provide an assortment of pizzas, tacos and fried chicken. However it tries to manage this, McDonald's also must watch out for its rivals improving their menus too. Wendy's, for instance, is developing its already successful Tim Hortons brand, which is a North American coffee-shop cum-bakery operation. KFC offers the option of mashed instead of fried potatoes and has started selling chicken with rice.

If more customers start to choose salads or toasted sandwiches, then the balance of the business will change

It remains to be seen just how far McDonald's can expand its menu while keeping its restaurants under the golden arches. As film-maker Mr Spurlock says: “People go to McDonald's to eat burgers.” But if more customers start to choose salads or toasted sandwiches, then the balance of the business will change. If that happens, would the McDonald's brand still work? The company has steadily been buying into chains that operate under different brands. Among them is Boston Market, bought in 1999. It operates 630 restaurants in America that boast high-quality “home-style” cooking. In 2001 McDonald's also acquired a minority stake in London-based Pret A Manger, a relatively upmarket coffee, sandwich and salads chain that has done well in Britain and is expanding overseas, with mixed results so far. McDonald's management are guarded about what they intend to do with such investments. But clearly they provide a hedge against the future, just in case existing McDonald's sites needed to be replaced with something radically different.

For now, that is far from necessary. Larry Light, who became global marketing chief in 2002 after running his own brand-building company, quickly trots out all sorts of figures to show how awareness of the McDonald's brand, already high, is actually growing. Next to Santa Claus, the most instantly recognised figure in the world by children is Ronald McDonald, the annoying clown who serves as the company's “chief happiness officer”. Television ads of his synchronised swimming and high-diving during the McDonald's-sponsored Olympic Games won the company lots of plaudits from the advertising industry this summer.

But Mr Light is doing things differently. “The days of mass-media marketing are over,” he says. The three main target groups the company is trying to influence are children, mothers and young adults. Teenagers, for one, are a tough lot to reach now that they spend more time on the internet than watching television. So marketing has to follow them there—or to the music charts by signing up Justin Timberlake and Destiny's Child as part of the company's ad campaign.

The food of love

The McDonald's brand is big, but it means different things to different people. It can also be positioned differently throughout the day, during breakfast, lunch and dinner, if you are eating alone, or with children. Hence the new advertising campaign that Mr Light launched, anchored around the catchy ditty “I'm lovin' it”, takes many different forms.

The campaign also has to deal with the most sensitive issue of all: the one portrayed by Mr Spurlock, which has it that eating at McDonald's makes you fat and ill. The company shows no sign of ducking this. The “supersize” portions have been phased out, even though McDonald's maintains that Mr Spurlock was simply acting “irresponsibly” by deliberately consuming so much food and limiting his physical activity.

Such things come with the territory, reckons Mr Bell. He likens it to what Australians call the “tall-poppy syndrome”: when you are the tallest in a crowded field, someone will try to cut you down. He agrees that obesity is a genuine problem, but believes his company can help by promoting more active lifestyles and offering more balanced food choices. Is that a marketable proposition? Mr Light, whose job it is to put this message across, thinks so. “If we behave responsibly,” he says, “we will be perceived one day not as the problem, but part of the solution.”

If McDonald's can pull that off, then it will have achieved a remarkable transformation, as well as having cemented the turnaround in its fortunes. What are its chances? Well, the company is trying pretty hard. In America it has been offering a meal for grownups, promoted by Bob Greene, Oprah Winfrey's personal trainer. It comes with a salad, bottled water, a book of walking tips and a pedometer.

While it is easy to dismiss this as just another sales gimmick, if only a fraction of the 30m pedometers that have already been sold end up being clipped to people's waistbands and succeed in encouraging them to walk a little further, then McDonald's may already have taken one small step toward helping an overweight America to slim down. And that will do its health no harm at all.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Emerging economies

Coming into flower

Oct 14th 2004
From The Economist print edition

Alamy

Growth in emerging economies is running at its fastest for at least three decades. Can the pace be maintained?

THE old “third world” is knocking spots off the rich world when it comes to economic growth. The International Monetary Fund expects “emerging market and developing countries” to grow by 6.6% this year, the fastest pace for at least 30 years. Indeed, all of the 25 emerging economies tracked each week by *The Economist* are currently enjoying positive GDP growth for the first time since we launched our emerging-market indicators over a decade ago (see article). Even this year's laggard, South Africa, is growing at a reasonable rate of 2.5%.

In the past, as one region sprinted, another usually stumbled, but today rapid growth is more evenly spread across emerging economies. Asia and the former Soviet Union are both expected to see GDP increase by close to 8% this year. Latin America, central and eastern Europe, the Middle East and Africa are all tipped to grow by around 5%. Top of the league are Turkey and Venezuela: both countries'GDP shot up by more than 13% in the year to the second quarter. China continues to grow at an annual rate of almost 10%. More surprising, given their history, are the performances of India, Argentina and Russia, which all enjoyed GDP growth of 7% or more in the year to the second quarter.

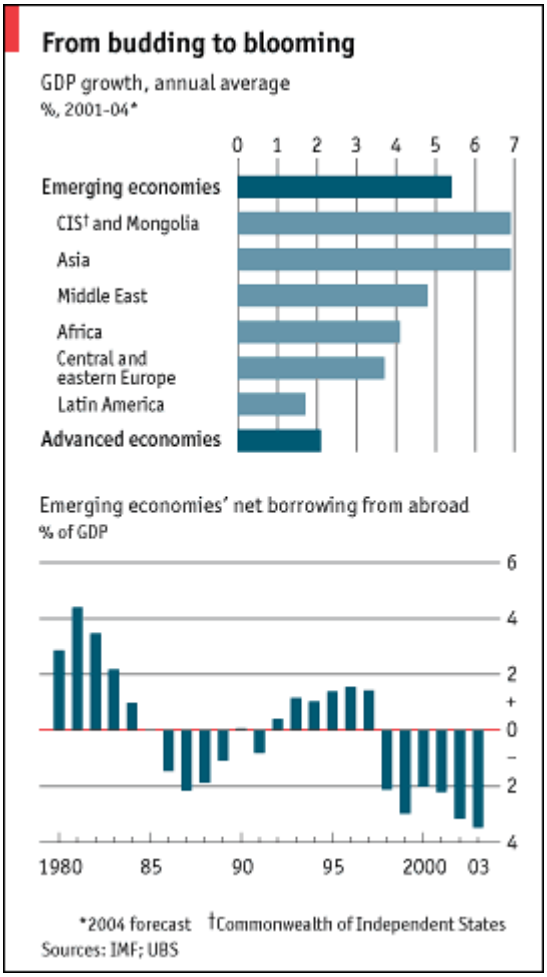
Emerging economies have been outpacing their richer brethren for a while: since 2000 they have grown two and a half times as fast as the developed world (see chart). The latest spurt is the result of several favourable factors. Strong demand in America and China has boosted global trade and triggered a surge in commodity prices: *The Economist*'s metals index is at a ten-year high. This has been a fillip to raw-materials producers, such as Brazil, South Africa and Russia. Low global interest rates have also reduced debt-service costs, and the fall in the dollar has improved the competitiveness of those currencies, notably in Asia, that follow the greenback.

Thanks in large part to higher commodity prices, even Africa's prospects are better than for many years. The continent is also benefiting from a recovery in agriculture after severe droughts in 2003 and from greater political stability. The IMF forecasts growth of 5.8% in sub-Saharan Africa in 2005, which would be

the highest rate in three decades. The Fund admits, however, that its forecasts have consistently overestimated African growth because of political turmoil and natural disasters.

Emerging economies' improved health is not only due to favourable external factors. Their basic financial health has also improved. Structural reforms and sounder macroeconomic policies have made them more able to sustain strong growth and to withstand adverse external shocks.

Thus inflation has been tamed and budget deficits have been trimmed: emerging economies are, on average, running much smaller deficits than rich countries. According to a recent study by UBS, a bank, emerging economies are less dependent on foreign capital than ever before. Collectively, they have run a current-account surplus for six consecutive years, having been in deficit for most of the previous 20. Unlike previous debt-financed booms, which were often followed by financial crises, the current expansion has been financed largely by domestic saving, allowing them to repay foreign debt.



Emerging economies' ratio of total foreign debt to exports of goods and services has dropped from 172% in 1998 to 93% this year; the ratio of debt-service costs to exports has fallen from 26% to 15%. Foreign-exchange reserves have swollen to eight months' import cover, compared with only five months' worth just before the Asian crisis in 1997. Moreover, most emerging economies no longer have the unsustainable, fixed exchange rates that have contributed to past financial crises. Officially, floating rates are now the norm. Many Asian countries do use foreign-exchange intervention to maintain informal pegs against the dollar, but as a result their currencies are, if anything, undervalued. In 1997, they were grossly overvalued.

If emerging economies are doing so splendidly, why aren't their stockmarkets racing? Morgan Stanley Capital International's emerging-market index has risen by a modest 7% this year in dollar terms. Latin American shares have enjoyed strong gains, but several Asian markets, notably in China and India, have actually fallen. Today share prices remain, on average, 20% below their 1994 peak. Many investors who got their fingers burnt in the Mexican, Asian, Russian and Argentine crises remain understandably wary.

Yet many of those markets currently look like a bargain. The Bank Credit Analyst, a Canadian investment-research firm, calculates that the average price-earnings ratio for emerging-market equities (based on forecast profits for the next 12 months) is only eight, the lowest on record and 40% below the ten-year average. The equivalent ratio for American shares is 17. Of course, shares in emerging markets should be cheaper because their prices are more volatile. However, more stable economic fundamentals have made these stockmarkets less bumpy than they were.

There's always a but

Despite all this, there are lots of risks that might trip up emerging economies. A slump in demand in America or China and a consequent fall in commodity prices is one possibility. A further rise in oil prices is another. A sharp rise in global interest rates is a third. However, some of the risks offset one another. For example, weaker demand in America would mean lower interest rates. Or suppose China's investment boom turns to bust: then global oil prices should fall. So although countries would see their exports to China falter, they would pay less for fuel imports.

Higher oil prices are clearly squeezing oil importers, but Jonathan Anderson, the chief Asia economist at UBS, argues that their effect tends to be exaggerated. It is commonly argued that higher prices hurt emerging economies more than developed economies because poorer countries are more oil-intensive. Indeed, their oil consumption is higher relative to GDP measured at market exchange rates. However, this version of GDP understates the true size of emerging economies relative to rich ones, because non-traded goods and services are much cheaper in poorer countries. Once this is taken into account, says Mr

Anderson, Asia's oil intensity is roughly the same as America's.

In any case, sounder policies and current-account surpluses mean that many emerging economies are better placed than in the past to withstand an oil-price shock. Some are in better shape than others, though. Latin American and central and eastern European economies still look more vulnerable than Asia. Brazil, for instance, despite its first current-account surplus in a decade, still has a huge foreign debt, and its exchange rate looks overvalued. Any fall in the *real* against the dollar would inflate the cost of servicing its floating-rate, dollar-denominated debt.

Emerging European economies have the least healthy external position. Hungary's frighteningly large current-account deficit, of 9% of GDP, and its reliance on short-term capital inflows are ringing alarm bells. The Czech Republic and Turkey also have big current-account deficits. In contrast, the surge in oil and commodity prices has brought Russia a current-account surplus of 8% of GDP.

There are almost certain to be more troubles in emerging markets over the coming years. But from the promising buds, fine flowers may blossom.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Parmalat

The gloves come off

Oct 14th 2004
From The Economist print edition

Enrico Bondi's battle with Parmalat's banks is getting ugly

UNTIL recently, the big banks that did dozens of deals with Parmalat before the Italian dairy-products group collapsed last December were quietly dismissive of Enrico Bondi. Not any more: the special administrator who is trying to rescue a viable business from a fraud-riddled mess has already proved himself a formidable operator. His case against Parmalat's banks and advisers has been steadily gathering momentum. So the banks are fighting back.

Mr Bondi has been persistent in his move against the banks, which include Citigroup, Bank of America (BofA), J.P. Morgan, Deutsche Bank and several others. On October 7th Bank of America became the latest bank to be sued as part of Mr Bondi's effort to reclaim $10 billion that he says was illegally siphoned out of Parmalat by its owners and bankers. BofA responded that it would defend itself vigorously.

Like an earlier suit against Citigroup, the case against BofA includes details further demonstrating just how close a relationship existed between bank officials and the top Parmalat managers who were allegedly running the fraud. So important a customer had Parmalat become that in June 2003 it received a visit from Kenneth Lewis, BofA's boss, who flew to Parma in his executive jet. Also on board was Luca Sala, a BofA employee who shortly afterwards was sacked for allegedly fiddling his petrol expenses. Mr Sala seems to have retained a close relationship with BofA despite his dismissal. E-mails seen by *The Economist* show that by July 2nd Mr Sala was working for Parmalat where he became the group's chief liaison officer with his former employer (in a curious echo of the switch, around the same time, by Alberto Ferraris, a Citigroup relationship manager who became Parmalat's chief financial officer). A joint BofA/Parmalat roadshow that planned to sell $300m of bonds to American investors was abandoned that month.

Among the allegations made by Mr Bondi is that BofA has “directly impeded” his investigation into the bank's role in Parmalat's collapse. Mr Bondi will have to prove in court that, as he alleges, the bank has hidden documents and blocked his access to important information about transactions in some offshore-banking centres. But a feature of the lawsuit is that even before there has been legal discovery, a process which normally allows a fuller reconstruction of what took place, Mr Bondi has shone light on areas of banking that normally remain obscure.

The lawsuit against BofA followed Mr Bondi's biggest success to date. On October 6th Nextra, the fund-management arm of Italy's Banca Intesa, agreed to pay €160m ($197m) to Parmalat. The sum represents its settlement of prospective charges that it bought and sold €300m of Parmalat bonds in the months before the collapse, knowing that there was fraud at the company. Banca Intesa said that it wanted to avoid protracted litigation, but maintained that its dealings with Parmalat had been “absolutely correct”.

That settlement creates two nasty problems for the rest of the banks. The first is simple precedent: Mr Bondi has reckoned for months that an effort led by BofA to agree a collective settlement has been largely intended to stall his legal proceedings—no money has ever been offered. Now he has shown that he is prepared to deal reasonably with the banks one at a time. The second worry is that Nextra was only one party to the €300m bond sale: the other was Morgan Stanley, and it is under intense pressure. It is thought to have offered Mr Bondi €70m, which he has rejected as insufficient. Discussions are still going on, but if Morgan Stanley decides to settle too, then the remaining banks' claims that they acted properly will look pretty untenable.

Citigroup is leading a fightback. On October 8th it sued the Italian government, claiming that it was

allowing the administration of Parmalat under Mr Bondi to treat creditors unfairly. This was a surprise. Only days earlier Charles Prince, boss of Citigroup, had paid a fence-mending visit to Carlo Ciampi, Italy's president. He was apologising for a recent controversy over trading activity by Citigroup in London that had disrupted government-bond markets, including Italy's. To enhance his charm offensive, Mr Prince wheeled out some of Citigroup's heaviest hitters, including Renato Ruggiero, a former Italian foreign minister who advises the bank. If Mr Ciampi was impressed, presumably it was only until he learned of Citigroup's lawsuit against the government.

Essentially Citigroup is contesting a decision made by Mr Bondi to exclude it from the list of Parmalat's creditors, a step that would, if upheld, keep the bank out of a future debt-for-equity swap prior to Parmalat's re-flotation on the stockmarket. Mr Bondi excluded around one-quarter of Parmalat's €22 billion-23 billion of credits, including all of Citigroup's and BofA's. A judge in Parma will rule on November 18th whether it was legal for him to do so.

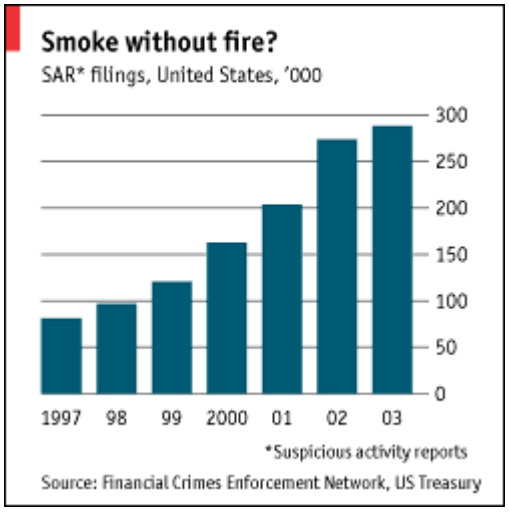
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Money-laundering

Coming clean

Oct 14th 2004 | NEW YORK
From The Economist print edition

Banks must fight money-laundering, but they need some help



CRIME doesn't pay, or so we are told. But the truth is that it can, if crooks manage to transform tainted money into “clean” cash. Money-laundering has been the target of enforcement agencies for years, but they have redoubled their efforts since the September 11th attacks. Though money-laundering is in some ways the opposite of terrorist finance—one takes dirty money and tries to make it look clean, the other uses money that can be legitimate for illegitimate ends—the investigations that followed those attacks showed just how easy it was to use banks for improper ends.

Banks are the conduit through which much of this dirty money enters the legitimate financial system. The IMF estimates that an amount equivalent to 2-5% of global output is laundered annually; Celent Communications, a Boston consultancy, reckons that almost half of this occurs in banks. The authorities think banks should be at the centre of the fight against laundering, but are disappointed by the efforts of many of them. In recent months, Citigroup, ABN Amro and Riggs Bank have all landed in trouble over shoddy money-laundering controls. On October 8th Standard Chartered said it had agreed to tighten its systems in New York after regulators found “deficiencies” at the bank.

In most countries banks have to put in place anti-money-laundering (AML) systems. They should know who their customers are and where their money comes from, and watch out for “suspicious” transactions. The first bit, though far from simple, is easier than the second. Detecting suspicious activities is a daunting task. Unlike, say, insider trading, money-laundering is rarely a one-off event. “It involves finding patterns, a much harder task,” says Alan Mangelsdorf of Mantas, a company that specialises in AML software.

Banks are spending huge sums on the search for clues. Celent estimates that financial firms in Europe and America spent over $5 billion on tackling money-laundering last year. American firms accounted for $3.6 billion of this, up from $700m in 2000, in part because more were required to install AML systems under the Patriot Act, passed by Congress after the September 11th attacks. The bulk went on training, technology and reporting systems.

Money alone is not the answer. There is a lot of confusion surrounding rules for monitoring suspicious transactions. In Britain, banks and others must report activities where there are “reasonable grounds” to suspect money-laundering. But this is subjective. America has similar laws and similar problems, but these are compounded by the patchwork of different bodies responsible for regulating banks, each with different standards and policies. Heeding banks' worries, the government is trying to co-ordinate the regulators' approaches.

Meanwhile, banks in America and elsewhere are trying to cover themselves by filing ever more “suspicious activity reports”. Regulators are swamped with information. Alas, most of it is useless. “For banks, there is no downside in reporting too much,” says Adam Bates of KPMG, a consultancy. “But for the financial system there is. It defeats the whole purpose.”

Banks say that more information from intelligence agencies would help. In both America and Britain, authorities are already sending banks lists of suspected money-launderers. Not enough, say banks: they want more information on scams or patterns to watch for. Intelligence agencies counter that this would

jeopardise investigations. Still, some middle ground might be found.

Sharing information is another big problem, because of privacy and data-protection laws. In America, the Patriot Act allows financial firms to share some information on suspected money-launderers with competitors by registering with the government. So far, 2,500 have done so, fewer than expected. The slow uptake is partly because of competitive issues; but it is also because of strict limits on the information that can be shared.

Co-operation across borders is harder still. The private sector is, of course, not privy to information that is passed between national governments and intelligence agencies. Even sharing information within a multinational bank is hard. For example, American banks are barred from handing on information received from intelligence agencies to their overseas branches. Launderers are presumably rubbing their hands with glee.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Central European stock exchanges

Allied or alone?

Oct 14th 2004 | WARSAW
From The Economist print edition

The pros and cons of consolidation

Reuters

For popular capitalism, queue here

HAPPY days, these, for central Europe's young stockmarkets. None looks bonnier than Warsaw's, the region's largest, which has been at record highs. Next month will mark the start of trading in shares in PKO BP, Poland's dominant, state-owned savings bank, of which 1.1 billion zlotys' worth ($315m) were sold to retail investors on October 11th. In Prague, the normally moribund stock exchange is still rejoicing at the first initial public offering in its 12-year post-communist history: Zentiva, a Czech drugmaker, raised 5.4 billion korunas ($211m) in June.

Nevertheless, central Europe's stockmarkets are under pressure—mainly to join forces in order to create more liquidity. Indeed, consolidation is already under way. In March, OMX, which already operated the Nordic, Estonian and Latvian exchanges, took control of Lithuania's stockmarket too. In May, the Vienna bourse and several Austrian banks acquired the Budapest exchange. This, hope the Austrians, heralds a network of regional exchanges. To their great joy, Wieslaw Rozlucki, the head of Warsaw's exchange, turned up in Budapest in August to help open a trading session, and stressed the need to deepen the region's shallow capital markets.

In fact, the Poles are not keen. Warsaw's exchange has held a grudge against Vienna since 2000, when the Austrians tried to lure trading of central European stocks away from national bourses to Newex, their joint venture with Germany's Deutsche Börse. (Newex flopped.) Warsaw's trading platform, moreover, is not compatible with Vienna's. It is, however, akin to that of Euronext, a firm born of a merger between the Paris, Brussels and Amsterdam bourses in 2000. Warsaw and Euronext already have links, and Mr Rozlucki might like to turn his exchange, via an alliance, into Euronext's hub for central European equities.

Mr Rozlucki has yet to make up his mind. The decision is not entirely his own: his company is still state-owned. Plans are afoot for privatisation next year—although with Polish politicians' fondness for national champions, it could take longer. Furthermore, Mr Rozlucki is keen on bolstering Poland's capital markets prior to joining any alliance. He has an ambitious strategy to double the bourse's capitalisation, to 50% of GDP, through new listings and tax breaks for small investors. “There is still a lot to be done at the national level,” he says.

An independent Polish bourse has its advantages. The stock exchange has worked hard to develop an equity culture. Roughly 40% of investors are individuals; in Budapest, by contrast, foreign institutions dominate. Some of the 65,000 Poles who bought shares in PKO BP this week had queued outside bank branches for days. Sizeable foreign companies, such as Bank Austria Creditanstalt and Hungary's BorsodChem, a chemicals manufacturer, think it worthwhile to list their shares in Warsaw. By the time it receives formal offers to join an alliance, Warsaw's market capitalisation may well have exceeded Vienna's. Another reason, perhaps, to defend its independence.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Bond markets

Ripe

Oct 14th 2004 | NEW YORK
From The Economist print edition

America's bond markets are due for scrutiny—and competition

CURIOUSLY, bonds were the first products traded on the New York Stock Exchange (NYSE) back in 1792. It took the exchange 30 years to put the “stock” in its name. The exchange lost any significant stake in the bond business generations ago. Now, though, caught in a war over the cost of trading shares, the NYSE quite rightly is looking at other markets with fatter spreads. And its attention has settled on old haunts. It has begun talks with the Securities and Exchange Commission (SEC) over permission to trade thousands of unlisted corporate bonds.

The obvious attraction of the bond market is its size: some $10 trillion-worth of corporate bonds traded in 2003, a quarter more than the trading volume on the NYSE. And yet the bond market's size and maturity ought to mean that there are no rich pickings left.

It has been hard, though, to tell how efficient bond markets are. In contrast to equities, information on the price of dealing in bonds has been scarce.

That began to change two years ago when the National Association of Securities Dealers began collecting transaction prices. This month the SEC released a study, based on these data, by its own Amy Edwards and Michael Piwowar, and Lawrence Harris of the University of Southern California. For all but the largest investors, trading bonds is many times more expensive than trading stocks. This is odd. In theory bonds should be no more expensive to trade than equities.

Even before sales commissions, the spread between what investors receive when selling $20,000-worth of corporate bonds and what they pay when buying is about 1.4%, or about one-quarter of a year's return. Costs are still higher in the convertible-bond market. And in the municipal-bond market, the spread reaches 2%, according to a similar study published by the SEC in the summer. All told, this is at least four times as expensive as a typical retail equity trade.

The prices of most corporate bonds are reported soon after trading. But for the portion of the corporate-bond market where prices are still not required to be reported, a $2 trillion segment in 2003, the study reckons investors paid an additional $1 billion in trading costs.

When trades are reported through the NASD, according to the study, trading costs fall by 10% to 14%. And that is only a start, because the NASD system is glacially slow, reporting prices with a 30-minute delay. Meanwhile, only dealers know where the market is trading. With immediate disclosure, says Mr Harris, transaction costs would undoubtedly fall farther. The benefits, he notes, would not be just to investors but to companies, because lower sales costs would make their debt more attractive to buyers. Bond dealers have long resisted efforts to shine a light on their markets. The study indicates why. For the NYSE, opportunity knocks.

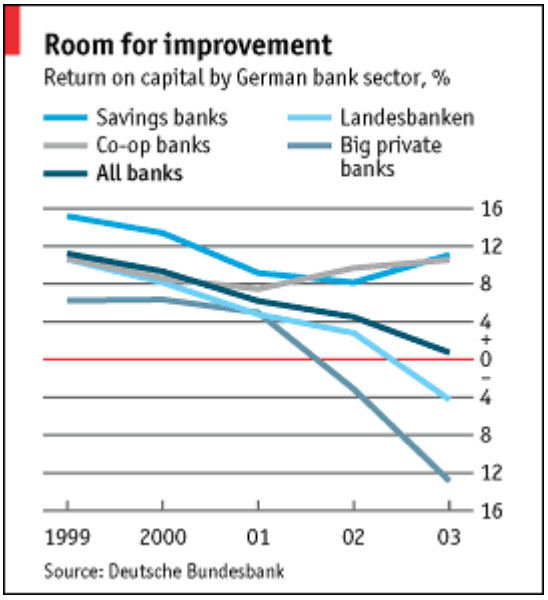
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Banking in Germany

Not so bleak

Oct 14th 2004 | FRANKFURT
From The Economist print edition

Public-sector banks are preparing for a tougher future



"IT'S the best thing that ever happened to us," says Günther Merl, head of Landesbank Hessen-Thüringen (Helaba). He is referring to a case taken to the European Commission in 1994 by Germany's private-sector banks against their public-sector rivals, such as Helaba. "It rather backfired," says Mr Merl.

That may sound odd, because the public banks lost. They will forfeit their state guarantees from next year, and last month were ordered to pay €4 billion ($4.8 billion) in back interest for assets funded at below market rates. But most of this money will return to them in the form of new capital from their owners, and the commission's ruling has sent a fresh breeze of competition through the state sector. While the private banks have been reducing their lending exposure, the public banks have been picking up business.

The public-sector banks—11 regional wholesale *Landesbanken*, a few development banks and nearly 500 savings banks—account for 36% of German banking assets and more than half of savings deposits. For years they have been protected by laws and state guarantees from the full force of the market. Since 2001 they have known that their privileges, including cheap funding, would end. The *Landesbanken* are not yet making money—although they are doing better than big private banks (see chart). But the public banks are reshaping themselves as far as they can, short of privatisation.

This week, Fitch, a rating agency, gave its blessing to S-Verbund, an alignment of local savings banks with Helaba. The binding of business policy and risk management under an active supervisory committee, with a consolidated balance sheet, is so strong that Fitch sees S-Verbund as a "single economic group". It bumped up its hypothetical unguaranteed rating for Helaba by one notch to A+, giving the flotilla of 51 savings banks the same rating.

Such links between savings banks and *Landesbanken* are likely to strengthen. Helaba is negotiating to buy Frankfurter Sparkasse, a so-called "free" savings bank (ie, which is not municipally owned). Savings banks in Bavaria, Baden-Württemberg and North Rhine-Westphalia, have also huddled around their local *Landesbanken*, but in a looser way. There has also been some consolidation between *Landesbanken*: recently one, Landesbank Rheinland-Pfalz, agreed to become a subsidiary of its neighbour, Landesbank Baden-Württemberg. All of this has persuaded rating agencies to give hypothetical ratings for next year of between A+ and A- to all the *Landesbanken* but one, enough to allow them access to normal funding in the capital markets.

Still, the *Landesbanken* face big challenges. Their original function, as wholesale banks and lenders to local governments, has left most of them with no retail base. They have always had to be wary of competing directly with savings banks, their part-owners, and with the mutual-fund business of DekaBank, which they own jointly with the savings banks.

Supra-regional mergers between *Landesbanken* are unlikely, notwithstanding Bayerische Landesbank's ownership of tiny Landesbank Saar. As for privatisation, some public-sector pragmatists believe this will happen within ten years. In North Rhine-Westphalia, local politicians have proposed the sale of minority stakes in savings banks. A bid by the mayor of Stralsund, a small port in eastern Germany, to sell the

local savings bank, was blocked by the state government early this year.

Some bankers, including Dietrich Hoppenstedt, head of the national savings banks association, see private ownership as the very devil. More than privatisation, others fear the pressure on short-term performance that comes from a stock-exchange listing. “Without being punished by quarterly reporting we can plan for the longer term,” says Helaba's Mr Merl.

In the next few years, however, structures such as those in Italy or Austria may emerge, in which savings banks are appended to listed holding companies. With capital expensive and local governments short of cash, the push towards shareholder value cannot be resisted forever.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Cross-border acquisitions

Very odd

Oct 14th 2004
From The Economist print edition

British acquirers do poorly in America, well in the EU

"BLOGGO PLC", announces its press office at 7am, London time, "last night agreed to purchase Junko Inc, of Wichita." A quote from Bloggo's proud chairman sets out how well the American purchase fits the British buyer's strategy. And the British shareholder, if he is wise, heads for his broker and the exit.

That, repeatedly, has been the lesson of British incursions into the United States: from attempts in the 1950s of firms like Austin and Morris to sell their utterly ill-suited and often ill-built small cars of the time, through European Ferries, which in the 1980s bought up several thousand acres near Denver, presumably without asking—until it went all-but belly up—whether a cross-Channel ferry firm really knew more about land in Colorado than local real-estate buffs did.

Even in the later era of serious direct investment, British incursions have had a spotty record. Two academics at Xfi, Exeter University's new finance and investment centre, have now put figures on it. Alan Gregory and Steve McCorriston studied 197 British takeovers in America, nearly all the significant ones, in manufacturing and services (banking excluded) in 1984-94. Over a five-year period from the purchase, they found, the cumulative return to shareholders was 27% lower than "normal"—ie, for similar companies that had stayed at home—and notably worse than the trivial difference over one year that stockmarkets (and academics) have tended to look at.

The figure was also in notable contrast to comparable ones from 97 takeovers in the European Union, and 39 elsewhere in the world. Returns in the EU looked better than normal, but the figures were not statistically significant; those in the rest of the world were both, 32% better.

You might expect the opposite, given that Britain's corporate culture is much like America's, but some way from those of most EU countries. So why the unexpected outcome? The Exeter academics do not know, but would love to find out—if they can get the research funding.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Economics focus

Cycles and commitment

Oct 14th 2004
From The Economist print edition

This year's Nobel prize honours two economists who have reshaped macroeconomic thought and policy

ECONOMIC ups and downs have always been a fact of human life. The Book of Genesis refers to “seven years of plenty” followed by “seven years of famine” in the land of Egypt. Only in the past 50 years or so, however, have economists used technical mathematical models to explain macroeconomic fluctuations. This year's Nobel prize, awarded on October 11th to an American, Edward Prescott, of Arizona State University, and a Norwegian, Finn Kydland, of Carnegie Mellon University, honours research that has helped improve the practice of economic policy, as well as economists' understanding of booms and busts.

The two professors' work is based on a reconsideration of some of the ideas of John Maynard Keynes, an English economist whose theories held sway in the two or three decades after the second world war. His “General Theory of Employment, Interest and Money” laid out themes that were heavily informed by the Great Depression of the 1930s. One was that economic recessions are caused in large part by a lack of “aggregate demand”, thanks perhaps to infectious bouts of mass pessimism.

While Keynesians were influenced by the hard times of the 1930s, this year's winners were inspired by the economic problems of the 1970s. Two features marked that decade. First, there was “stagflation”, a combination of slow growth (or outright contraction) and high inflation. That perplexed many Keynesians, who thought that inflation came mostly with rapid growth. The 1970s also saw a new desire among economists to understand an economy as the sum of millions of decisions by consumers and businesses, based ultimately on tastes and technological constraints; Keynes and his followers had tended to view the economy in aggregate terms, as if from a mountain top.

Thanks to this new emphasis on a bottom-up, or microeconomic, approach, Mr Kydland and Mr Prescott were able to craft their most enduring work. In a paper in 1977, they demonstrated the importance of credibility in economic policy. If governments cannot commit themselves credibly to a course, their policies may be futile.

Examples abound, showing the wide applicability of their work. A government might, for instance, want to discourage building in areas prone to hurricanes. So it warns citizens that no compensation will be given for houses in such areas should disaster strike. If people believe the warning, they will not build. But if they expect (as history suggests they should) that the government is likely to soften its stance and pay for hurricane damage after all, they will ignore the warning. Before the fact, the government wants to stop building; afterwards, it wants to compensate those who have suffered. Mr Kydland and Mr Prescott refer to such conundrums as “time consistency problems”.

The laureates focused on two areas where time consistency is most vexing: taxation and monetary policy. Suppose, for example, that a government promises that it will keep taxes on capital low in the future in order to encourage saving today. When the future comes, however, it has an incentive to tax accumulated capital heavily. Anticipating confiscatory taxes in the future, citizens will not save their money at all, but spend it before the government can grab it.

However, Mr Kydland and Mr Prescott have had by far their biggest real-world impact on monetary policy. A government's inability to demonstrate sincerity in achieving low inflation can, they showed, lead consumers to make high inflation a self-fulfilling prophecy. In essence, since the state has an incentive to favour inflationary policies—for instance, to cause a temporary boost in prosperity before an election—individuals should expect it to do so and should bid up wages.

That insight resonated during the high-inflation 1970s. It led to a shift in focus from the specific decisions of central bankers towards how to create credible institutions. Central banks should, under this thinking, obey transparent rules rather than have discretion to create policy. Increasingly, central banks around the world have been made independent of fickle politicians, and inflation has abated. Few academic papers have led to such great gains in practice.

Demand a better explanation?

Mr Kydland's and Mr Prescott's second Nobel-worthy idea, a new theory to explain business cycles, is more squarely opposed to Keynesian thought. Rather than chalking up booms and busts to the vagaries of demand, as Keynes had done, they asked whether changes in technology, or other supply shocks such as a rise in oil prices, might be as important. After all, the American economy had grown sevenfold in the previous 100 years, thanks largely to improvements in technology. Might lulls in innovation be a prime cause of recessions, and surges a source of booms?

As it turns out, the professors found in one model that such fluctuations in technological growth could account for 70% of the swings of American business cycles in the post-war years. This theory of “real business cycles” remains controversial. Many economists doubt that a depression like that of the 1930s could be explained mostly by variations in the pace of innovation. Yet even sceptics have incorporated Mr Kydland's and Mr Prescott's techniques of forward-looking, rational economic actors in models addressing questions phrased in more Keynesian terms. And all economists now give more weight to things like technology, productivity and oil prices in explaining recessions.

The debate about real business cycles is likely to persist. But, at the very least, Mr Kydland and Mr Prescott have earned their award by questioning the assumptions on which governments base—or used to base—their economic policies. Having put the decisions and expectations of people and firms at the centre of their theories, they have helped to make economic theory and practice all the more credible.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Correction: Czech interest rates

Oct 14th 2004
From The Economist print edition

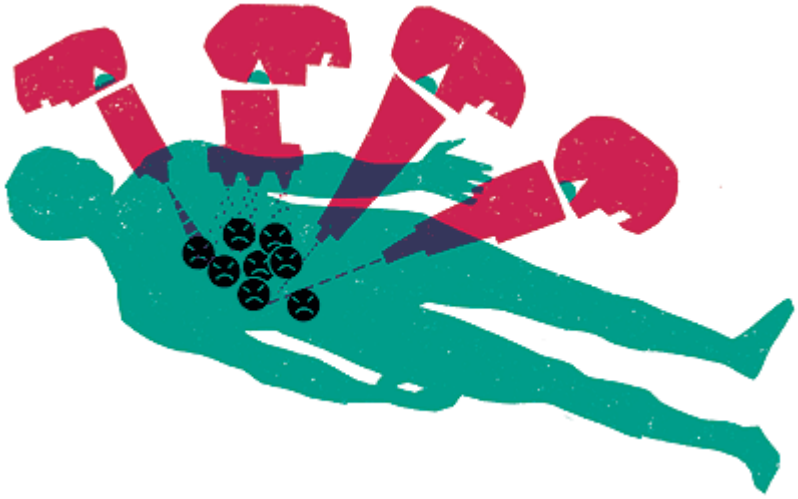
In last week's issue ("The flying forint") we said that the Czech Republic's official short-term interest rate was 1.5%. The correct figure is 2.5%. Apologies.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The future of cancer treatment

Up close, and personal

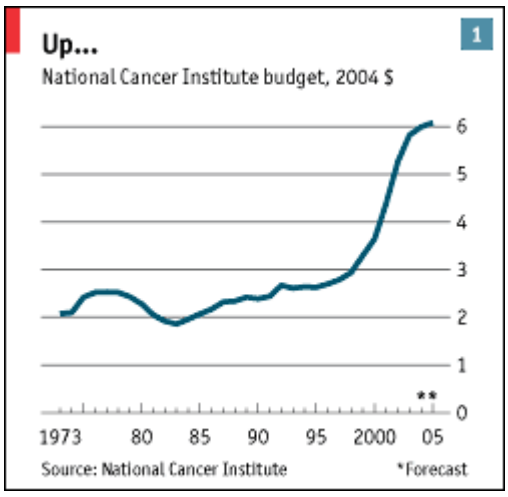
Oct 14th 2004
From The Economist print edition



There never will be a "cure for cancer". But a multiplicity of new ideas promise treatments for the multiplicity of diseases that cancer actually is

GOING by the numbers, humanity seems to be losing the war on cancer. According to the most recent data from the World Health Organisation, 10m people around the planet were diagnosed with the disease in 2000, and 6m died from it. And these numbers are growing. With an ageing population, the spread of western-style diets, and increasing tobacco consumption, cancer is on the rise around the globe. In America, for example, projections suggest that 40% of those alive today will be diagnosed with some form of cancer at some point in their lives. By 2010, that number will have climbed to 50%.

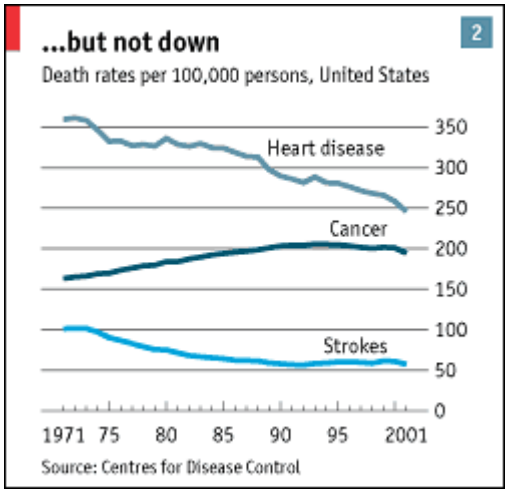
All this is despite the fact that, since then-president Richard Nixon's famous speech in 1971, launching what became known as the war on cancer, America has given nearly $70 billion (in actual, not inflation-adjusted, dollars) to its National Cancer Institute (NCI). And that is not to mention the money spent by drug companies and charities—nor, indeed, the research budgets of other countries. Despite these billions, the rate of death from cancer in the United States has increased from 163 per 100,000 individuals in 1971 to 194 per 100,000 in 2001. By contrast, mortality rates from heart disease and strokes, two other diseases often seen as being associated with affluent styles of living, have fallen (see chart 2).



Luckily, these numbers do not tell the whole story. In fact, scientists are optimistic about the future of cancer treatment. Very optimistic. As Paul Workman, director of the Cancer Research UK Centre for Cancer Therapeutics, a charity, puts it, "This is the second golden era of cancer research." While no one expects a cure for cancer in the next decade, many think it could be demoted to the status of a chronic disease that people can live with—in other words, something more like diabetes.

Multiplication and division

Cancer is characterised by uncontrolled cell growth. Healthy cells regulate their division into daughter cells carefully, subordinating their own Darwinian tendency to reproduce in favour of the survival of the body they inhabit. It is one of the marvels of evolution that they are able to do this, and so allow the development of multicellular creatures. But evolution works on many levels, and it is almost inevitable that mutations in some of the trillions of cells that make up a human body will disable the regulatory genes. Then it is just a matter of the survival of the fittest among cells. In a competition between regulated and unregulated cells, the unregulated ones will multiply faster, and win. The result is cancer.



Most current therapies—drugs that were developed during the first golden era, in the 1970s—simply attack dividing cells. That stops tumours, but it also kills all rapidly proliferating cells, regardless of their origin, function or state of health. The action of these drugs on normal tissues causes the side effects, including nausea, fatigue and weakened immune systems, associated with cancer treatment. By contrast, the new generation of drugs, several of which are already in the clinic, attack only deranged cells. These drugs are designed to fix the specific molecular problems in a tumour that drive its growth.

The best known of these new drugs is Gleevec (or Glivec, depending which side of the Atlantic you live on). It was designed to halt a blood cancer called chronic myeloid leukaemia (CML), which is characterised by the overproliferation of white, myeloid blood cells. CML is caused by the union of two chromosomes, numbers 9 and 22. When these chromosomes break, and their parts then join to form a 9-22 hybrid chromosome, they bring together two genes, called *BCR* and *ABL*. The novel protein made by the gene which results from this union is known as BCR-ABL. (A medical convention distinguishes the names of genes from the names of the proteins they produce by italicising the former.) BCR-ABL is one of a class of enzymes known as tyrosine kinases, which are involved in signalling pathways within cells. In the case of BCR-ABL, the signal generated tells the myeloid cells to proliferate continuously. Gleevec blocks the activity of BCR-ABL by sitting in the enzyme's active site. This switches off the signal to grow, and the cancer stops proliferating.

While the details of the molecular damage behind CML may seem arcane, they are central to the success of Gleevec and drugs like it. Without such information, the likelihood of stopping a disease with targeted drugs is small.

The story of another targeted molecule, Iressa, illustrates that point. Iressa blocks the activity of a different tyrosine kinase, called EGFR. This enzyme is present in many types of healthy cell, but is over-abundant in 80% of lung cancers. Given this pattern, and the fact that EGFR, like BCR-ABL, stimulates cell division, researchers hypothesised that the drug would be an effective treatment for the majority of lung-cancer patients. Instead, only about 10% of such patients had a strong response to Iressa—although the disease's progression was slowed down in another 30-40%.

Three studies published over the summer explain this lower-than-expected response rate. The patients who responded strongly to Iressa not only had lots of EGFR, they also had a mutant form of the enzyme. By contrast, those patients who had either no response or a partial response may have had an over-abundance of EGFR in their tumours, but it was the normal version of the enzyme.

That finding points to a crucial requirement for the new drugs that was not necessary with the old sort: careful patient selection. To deploy targeted therapies effectively, researchers need to find ways to identify those patients who will respond and those who will not. Otherwise, not only will drugs that have been approved for use be wasted on those who cannot benefit, but useful drugs may look useless when they are being tested for regulatory approval—and may thus be rejected altogether.

The elucidation of why some patients respond to Iressa and others do not proves that targeted therapies will work, according to Brian Druker, from Oregon Health Science University in Portland, who developed Gleevec. As long as researchers understand the crucial molecular abnormality in a cancer, design a drug to fix that problem, and use it in only in patients who have that molecular anomaly, then such targeted therapies can be effective.

The need for combinations

In general, the academic community and pharmaceutical companies agree with this assessment. Where they differ is on the likelihood of identifying one key mutation that underlies a given cancer. CML is unusual because only one mutation, the chromosomal junction between the *BCR* and *ABL* genes, drives the disease. By the time most cancers are diagnosed they have four or five mutations that researchers think contribute to the disease. That means one “silver bullet” drug is not likely to act as a cure, and may not even slow things down much.

Given the complexity of the problem, then, researchers see a need to combine several drugs into a therapy so that several mutations can be treated simultaneously. That is not, it must be said, a new idea. Combination therapies are standard for most cancers (and also for AIDS). But most existing treatments include several of the traditional, non-specific drugs. The trick now is to work out how to build successful combinations using the new generation of targeted drugs.

The first such combinations, which are already in use, merge a lone targeted therapy with one or more traditional agents. For example, Herceptin, an antibody-based drug that stops the activation of a cell-surface receptor protein called HER-2, is often paired with traditional therapies in breast-cancer care. In such regimens, the targeted therapy's role is to make the tumour particularly vulnerable to the traditional drugs. The problem with such combinations is that they do not make the traditional drugs any less toxic. So, while they may improve a patient's prognosis, they are not a panacea.

A more forward-looking approach is to try to combine several targeted agents. In one example, researchers at the Sarah Cannon Cancer Centre in Nashville, Tennessee, have tested the combined ability of two drugs to treat kidney cancer. Avastin blocks angiogenesis (the formation of the new blood-vessels which feed and oxygenate a growing tumour) and Tarceva is another inhibitor of EGFR. When presented at a scientific meeting in June, the work was lauded as the beginning of a new trend. However, it is not yet clear whether this particular combination is really any better than tyrosine kinase inhibitors are when they are used alone.

Science aside, the next big hurdle for combination therapy is the issue of intellectual property rights, according to Richard Pazdur, director of Oncology Drug Products at the Food and Drug Administration (FDA), the organisation that regulates medicines in America. Companies will have to find ways to combine and test their drugs with those of others, in order to produce the best combinations possible.

Although several company executives have expressed a disinclination to test their drugs in combination therapies before approval, Dr Pazdur is emphatic that the agency will consider—and encourages—such trials, as long as there are scientific data to support the approach. Furthermore, many researchers see these efforts as necessary for the success both of individual drugs and of progress in the field as a whole. Some drugs may not have sufficient power to be approved on their own, but would do so if evaluated in combination with others, according to Daniel Von Hoff, an oncologist at the University of Arizona, in Tucson. Thus developers who hesitate to put their new product into such tests may lose out in the end.

Picking the right target

All this targeted therapy, though, will be of little use if it is aimed at the wrong target. And that points to the other part of the second golden age of cancer treatment, which is not treatment at all, but better diagnosis.

The most promising new diagnostic technology is the DNA microarray (or “gene chip”, as it is colloquially known). Gene chips can do two things that are relevant to cancer diagnosis. They can identify mutations in particular genes, and they can monitor the activity of lots of genes at the same time—showing a doctor which genes in a tumour are busier than they should be, and which are less busy. Such chips have been crucial in dividing what appear, under the microscope, to be single diseases into smaller groups based on their precise molecular biology (as in the case of lung cancer mentioned earlier). And it is gene-chip technology that is most likely to usher in the era of “personalised medicine”, which many see as the future of medical treatment, and in which a “read out” of a disease's details will result in an individually tailored treatment.

The trick now is to work out how to build successful combinations using the new generation of targeted drugs

To a limited extent, such personalised care is already available. Breast cancers, for example, are regularly tested for the overexpression of HER-2, and only those patients whose cancers have the protein are treated with Herceptin. But the TRANSBIG clinical trials group, based in Brussels, intends to go

further. It started a trial earlier this year to determine whether microarray data can be used to identify which breast-cancer patients need back-up chemotherapy after surgery, and which can get away without it.

At the moment, the vast majority of breast-cancer patients receive such post-surgical treatment (95% in the US and 85% in the EU), even when their lymph nodes appear disease-free, and thus they would seem to be at limited risk of cancer cells spreading to other parts of their bodies. It is clear that only a few of these women gain a significant benefit from this additional therapy, while most suffer its side effects. Unfortunately, researchers have been at a loss to distinguish between those who can safely skip chemotherapy, and those who cannot. The TRANSBIG trial will assess the ability of microarray data to distinguish between these two groups by testing 5,000 women for the expression patterns of 70 genes. This is the first trial to test the ability of microarray data to direct clinical decisions. It will be completed in 2010 or 2011.

Look to the future now

The targeted drugs now appearing on the market should, if all goes well, be just the first wave of new anti-cancer therapies. The armoury will expand rapidly over the next five years as more targets are identified, and new classes of drug pass muster with the regulators.

For example, one target that researchers think promising is a gene called *B-RAF*. The protein from this gene is overexpressed in 80% of melanomas (a type of skin cancer) and in 20% of cancers of the colon and rectum. Besides being a likely target, it is thus also an example of something that might cause oncologists to shift the way they look at their subject, and start classifying tumours not on the basis of which tissue is affected, but which gene, or genes, have gone wrong.

As to the drugs themselves, one class that is likely to grow over the next five years is that based, like Herceptin, on antibodies. An antibody is a protein produced by the immune system to knock out an infectious agent such as a bacterium. Each antibody molecule has two sites specifically tailored to lock on to a protein that occurs in the invader but not in the human body. However, antibodies that stick to human proteins can easily be made in the laboratory. And if the protein in question is found mainly in tumours, the antibody might—as in the case of Herceptin—make a good drug.

Even if it does not, however, it can be used as a delivery van for a drug that does work, but which is too poisonous to be allowed to wander freely through the body. Nor does the payload have to be a drug. It can be a radioactive isotope—allowing radiotherapy designed to kill tumour cells to be directed to those cells alone. Several such drugs have already proved their value in blood cancers, substantially improving the treatment of diseases such as non-Hodgkin's lymphoma. Antibodies also form the basis of Avastin. And such anti-angiogenesis drugs are a further promising avenue of research.

Another approach is to try to recruit the immune system directly, by stimulating it with a vaccine (and possibly bolstering it with extra antibodies) to attack the tumour as though it were an invader. Such immunotherapy looked promising in the past, but ultimately failed the challenge.

At that time, the thought was that a response sufficient to destroy a full-blown tumour might be stimulated. This, researchers now understand, was too much to ask, according to Jedd Wolchok at the Memorial Sloan-Kettering Cancer Centre, in New York. Instead, these therapies might serve to limit the recurrence of tumours, or to kill stray cancer cells left over after the bulk of a tumour has been removed by the surgeon's knife. Researchers are therefore eagerly awaiting the first results from a big clinical trial of a vaccine called Canvaxin. If this trial, which is directed against malignant melanoma, works, it will provide an important proof of concept for other immunotherapies.

And there are even wilder ideas around. In the early 1990s, researchers in California conceived of modifying an adenovirus (the sort that causes colds) so that it would kill cancer cells, and those alone. The first tests were unsuccessful, but since then investigators have tweaked the virus and think they have a version that is likely to work. They hope to start the first phase of clinical tests with the new virus in brain-cancer patients later this year. Meanwhile, another group is testing a similarly modified virus in patients at high risk of developing mouth cancer. In this case, the virus—which is intended to stop a tumour developing in the first place—is delivered as a mouthwash.

The most important change of all, however, will be early diagnosis, according to Lee Hartwell, the director of the Fred Hutchinson Cancer Research Centre, in Seattle. The more advanced a cancer is when

it is diagnosed, the more likely it is that the tumour will already have developed genetic tricks to escape even the best drugs. Even a pea-sized tumour has a billion cells. That provides it with a lot of chances to evade treatment.

Already, body scanning, in the forms of computerised tomography, magnetic-resonance imaging and positron-emission tomography, provides physical and chemical detail far beyond that available during the first golden era of cancer research. Within the next decade, these techniques will be combined with new radioactive and fluorescent probes that will enable doctors to see small clumps of precancerous cells. Edison Liu, executive director of the Genome Institute of Singapore, likens this to a “Star Trek-ian” scan of the body, in which doctors may be able to see clumps of deregulated growth containing as few as ten cells. They will also be able to tell what molecules are causing the problem. So if, for example, a patient's EGFR is out of whack, they can treat him with a molecular inhibitor such as Iressa or Tarceva well before any symptoms appear.

With tools like this available, it may be that having a 50% probability of being diagnosed with cancer if you are an American will prove to be an underestimate. But your chance of actually dying of the disease will soon, itself, be dying.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Islam and the West

The new with the old

Oct 14th 2004
From The Economist print edition

AP

How Muslim fundamentalism has a thoroughly modern streak

Get article background

MAYBE it is a by-product of academic Marxism, or it may go right back to the scholastic theology of the Middle Ages: the best French scholars seem to have a natural advantage over their Anglo-Saxon counterparts in the business of ideological anatomy. With relish and sharpness of mind, they can take a huge body of thought, most of it baffling to outsiders, and tease out the main strands, showing the bizarre ways in which they diverge and converge. Another gift of French academia is a keen sense of the way in which almost any impulse—in philosophy, politics or any other field—tends to generate its opposite; and, hence, of the paradoxically close relationship between people, movements and trends which appear to be radically opposed.

The results of this high-octane brainwork are not always appealing to English-speakers; but when the topic is political Islam, and the authors are among the leading French (and international) authorities on the subject, people who care about the future of the world can hardly fail to prick up their ears. They will not be disappointed. Neither Olivier Roy nor Gilles Kepel conforms to any stereotype of the Parisian egghead, yet they make full use of Gallic gifts in their latest analyses of the Islamist response, whether peaceful or violent, to the liberal, capitalist West.

At the heart of both works is an understanding of a central paradox: in all its varieties, whether political, pietistic or warlike, Muslim neo-fundamentalism is an essentially modern phenomenon. The more stridently it calls for a return to the "old-time" religion of 1,400 years ago, with all later additions removed, the more contemporary this movement looks.

In "Globalised Islam", published in French in 2002 and newly issued in an updated and revised English version, Mr Roy takes a broad look at the way in

Globalised Islam: The Search for a New Ummah
By Olivier Roy

Hurst; 349 pages; £30 (hardback) and £16.95 (paperback).

Buy it at
Amazon.com
Amazon.co.uk

The War for Muslim Minds: Islam and the West
By Gilles Kepel

which militant Islam is expressed and organised in a world where people, ideas and electronic messages move swiftly across borders that used to be sealed. As he convincingly argues, the striking revival of outward piety among the second generation of families which have moved from Islamic countries to the West does not in any way imply a slowdown of modernisation. Precisely because traditional cultures, societies and extended families are breaking down, both among immigrants and in their home countries, a younger generation of Muslims in the West is attracted by the idea of a simple, stentorian version of their faith, stripped of the cultural accretions that were built up in the “old country” over many centuries, and compatible with modern patterns of consumption.

Belknap Press; 336 pages; $23.95 and £15.95

Buy it at
Amazon.com
Amazon.co.uk

To take one crude example, young European Muslims are more likely to demand halal hamburgers at their school than to take an interest in the elaborate recipes by which forebears in Pakistan or Algeria broke their fasts. For angry, restless young Muslims, a back-to-basics version of the faith can be a way of protesting against their parents as well as against their host societies; it fills the same space as radical leftism did in a previous French generation, and as counter-cultural rap does in America's ghettos. Even suicide bombing, whose indifference to individual life might seem deeply unmodern, is presented by Mr Roy in a contemporary light. As he argues, the culture of suicide attacks—as fostered by al-Qaeda and its imitators, and promoted on their websites—has a self-indulgent, me-generation flavour about it. The narcissistic characters who carried out the September 11th attacks were no exception to this.

Mr Kepel's book is less about ideology and culture and more about war and geopolitics; with a full account of the Madrid bombings last spring, and the upsurge of fighting in Iraq at around the same time, it is remarkably up to date. The book includes a succinct anatomy of America's neoconservative camp, along with that camp's bitterest enemies in the world of ultra-militant Islam. It shows how both these parties were intensely frustrated by the Oslo peace process, and relieved by its collapse. In an extended look at the psychology of Ayman al-Zawahiri, an Egyptian doctor and second-ranking figure in al-Qaeda, Mr Kepel argues that there, too, is a ruthlessly modern mind. Far from being a bone-headed, backward-looking nihilist, the strategist who conceived the September 11th attacks on America is credited with an up-to-the-minute sense of global trends and opportunities. His top priority, in Mr Kepel's view, was not nearly so much to inflict devastating damage on the western enemy, as to galvanise the Muslim masses against their own governments. He wanted to show the spectacular results that *jihad* could achieve.

Neither Mr Roy nor Mr Kepel has a trace of visceral anti-Americanism, but Mr Kepel is unsparing in the way he contrasts Iraq's present situation with the post-Saddam vision once promised by the neoconservatives: an ever-widening virtuous circle of democracy, peace and economic reform with Baghdad at its heart. He also insists that ultra-militant Islam has not won either. From the West Bank to Baghdad to Kabul, there is *fitna*—disintegration and chaos—in the land of Islam.

Yet Mr Kepel ends on an unexpectedly upbeat note. It is possible, the author suggests, that European Islam might evolve in new ways that could co-exist with modernity, asserting its distinctiveness without pretending, dishonestly, to live in another century. If that happy scenario were to unfold, Muslims and non-Muslims alike would need a keen sense of what modernity and tradition really mean. In the development of such an understanding, both these books can make a large and highly intelligent contribution.

Globalised Islam: The Search for a New Ummah.
By Olivier Roy.
To be published in America by Columbia University Press in November
Hurst; 349 pages; £30 (hardback) and £16.95 (paperback).

The War for Muslim Minds: Islam and the West.
By Gilles Kepel.
Belknap Press; 336 pages; $23.95 and £15.95

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Religious tolerance

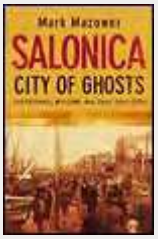
A big tent

Oct 14th 2004
From The Economist print edition

EIGHTY years ago, workers from Save the Children, a British charity, were labouring in Salonika harbour to succour the hundreds of thousands of Greek refugees from Anatolia who had turned the warehouses into homes, freezing, insanitary and rife with typhus and smallpox. At the same time, a huge wave of forced migration went in the other direction: Muslims from the city and its environs were being shipped away to Turkey, under a Greek-Turkish (or more precisely Christian-Muslim) exchange which made both countries ethnically much more homogeneous. Two decades later, the old, multi-ethnic character of Salonika took a final, devastating blow. From March 1943, some 45,000 members of the Jewish community, which had dominated the city's life for much of the previous 500 years, were taken away to Auschwitz and gassed.

While a recent inflow of migrants from eastern Europe has restored to Salonika some of its old diversity, not much in today's spanking modern city reminds the visitor of a rich, cosmopolitan past: only the ghosts evoked by an occasional Jewish or Ottoman building, if you are sensitive to that kind of thing. Mark Mazower is prodigiously endowed with that sensitivity. He has produced a brilliant reconstruction of one of Europe's great meeting places between the three monotheistic faiths.

Salonica, City of Ghosts: Christians, Muslims and Jews
By Mark Mazower



HarperCollins; 544 pages; £25.

Buy it at
Amazon.com
Amazon.co.uk

As Mr Mazower shows, many of the Iberian Jews who arrived in the late 15th century, fleeing Christian persecution, were already the products of religious ambivalence. Some were from families which had converted provisionally to Christianity but re-embraced Judaism; a few were dissident Christians. Against a backdrop of spiritual ferment in the 17th century, many followed Sabbatai Zevi, a Jewish scholar, who proclaimed himself Messiah and eventually embraced a form of Islam. In popular piety, much overlap existed among the faiths. The tomb of Saint Dimitrios, regarded by Christians as the city's protector, was inside a mosque where both Christians and Muslims went to seek blessing.

Among Balkan-watchers, it is a commonplace that the relatively tolerant tradition of Ottoman Islam is at risk of being replaced, in places like Bosnia and Albania, by Saudi-financed fundamentalism. Ottoman Islam cannot be revived, nor would anybody want it revived in its undiluted form—no need to romanticise about a world where the penalty for apostasy from Islam was death. Yet the very fact that an extraordinary variety of religions did co-exist in Salonika is a powerful response to those who insist that the faiths and ethnic groups of south-eastern Europe should at all costs be prized apart.

Salonica, City of Ghosts: Christians, Muslims and Jews.
By Mark Mazower.
To be published in America by Knopf in April 2005
HarperCollins; 544 pages; £25.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Europe's early encounters with Asia

East meets West

Oct 14th 2004
From The Economist print edition

Two fine exhibitions suggest mutual fascination, and even respect

“I CAN'T understand what you are saying,” cries the Nagasaki prostitute to the Dutchman in an 18th-century woodblock print: “Just push! Do it harder!” To judge by the barbarian's claws at her thighs, and the incense to cover his rancid breath, the woman wants to get this East-West encounter over with fast.

The print would seem to reinforce official versions even today of the West's rapine plunder of the East in history. But a fine exhibition at London's Victoria and Albert Museum until December 5th, “Encounters: the Meeting of Asia and Europe 1500-1800”, paints a subtler picture of early meetings between East and West. Through the careful choice of some 200 objects, many of them extraordinary, the curators, Anna Jackson and Amin Jaffer, set out to explore the early relationship between Europeans and Asians. The irresistible conclusion is that this was an age characterised not—or not chiefly—by hostility and incomprehension, but rather by a fluid, hybrid fusion of cultures, underscored by mutual fascination and even respect. The West's hostility towards Asians, the racism, the power politics and even brute oppression—that was largely for later.

In 1498 Vasco da Gama landed near Calicut, on the Malabar coast. He first sent a Portuguese convict ashore, to bear any risk; this man met, not an Indian, but a Tunisian Muslim speaking Genoese. “We come in search of Christians and spices,” said the convict. In 1521, Magellan found those spices in abundance, in the Moluccas in eastern Indonesia.

For all the West's sophistication in nautical technology, mindsets were singularly ill-calibrated for these very early encounters. Da Gama offered the king of Calicut 12 pieces of striped cloth, six hats and not much else; the coarseness of western dress seems to have shocked Asians used to finely printed cotton and silk. Unable to understand Asian conventions of business and diplomacy, da Gama resorted to force and superior weapons.

There were intermittent brutalities on both sides—for instance, the Dutch slaughter of thousands in the Spice Islands, and the Japanese persecution of Catholic missionaries and their 150,000 followers in the late 16th century. Yet a different story is told by a wonderful Japanese scroll that shows three men of learning from Japan, China and Europe discussing scientific affairs, while behind them their respective compatriots demonstrate their own methods for putting out a blaze. A different story is told, too, by the tender portrait by Johann Zoffany of the mixed-race Palmer family in Lucknow.

The exhibition, though wide-ranging, has limits. The West's encounters in India, China and Japan are explored while other places of hybridity, like South-East Asia, go generally uninvestigated. Even then, the exhibits are relatively few. This has given rise to complaints. Yet any more objects would have risked that sense of overload too often felt by visitors to a blockbuster show. Besides, a book accompanying the exhibition amplifies it well.

Pacific portraits

A pity of the earliest European encounters of Asia is that no painters attended to record them. This is what makes so special the work by William Hodges, who accompanied Captain James Cook on the second of his voyages to the Pacific between 1772 and 1775 (Zoffany, Cook's much better-known first choice, had pulled out). Hodges's striking paintings of the voyage are among those on display in an exhibition of this neglected artist's work at the National Maritime Museum in Greenwich until November 21st; it moves to the Yale Centre for British Art next January.

Certainly, Hodges's paintings and sketches are refracted through the lens of empire. Yet he was too acute an artist for propaganda. His depictions of Tahiti and surrounding islands are remarkable recordings and point ahead to the anthropological disciplines of the 19th century.

Later, with Warren Hastings of the East India Company as his patron, Hodges was to paint such superbly intimate portraits of a hybrid Indian culture as would have sat well in the “Encounters” exhibition at the V&A. When he returned to Europe, he never rediscovered his poise, dying broke and forgotten in Devon. This exhibition goes a long way to redeem him.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

National Geographic Society

Kith and kin

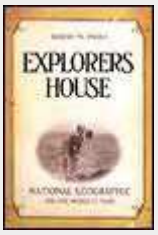
Oct 14th 2004
From The Economist print edition

IN HIS history of the National Geographic Society, founded in 1888, Robert Poole presents a plausible case for nepotism. He shows how five generations of a public-spirited family, “a proud and private New England clan”, converted a boring academic journal into an internationally loved magazine, one with millions of loyal subscribers.

His real starting point is not 1888 but 1898, the year that the National Geographic Society came under the control of Alexander Graham Bell, the inventor of the telephone. Bell also happened to be the son-in-law of the society's founder, and the main asset that he acquired from his father-in-law was the magazine. It then had a circulation of around 1,000, which the inventor was determined markedly to increase.

Bell was a journalist manqué. He came up with countless story ideas. Why not write about waltzing mice, he would ask, or China's influence in the Philippines, the meteorites of Canyon Diablo, breeding frogs, polar exploration, Spanish earthquakes, yellow fever and auroras? What he needed was a detail man, somebody to commission the articles, select the illustrations, edit the copy, lay it out and get it into print. Successive generations of Grosvenors admirably filled the role, starting with Bell's son-in-law, Gilbert.

Explorers House: National Geographic and the World it Made
By Robert M. Poole



The Penguin Press; 357 pages; $25.95

Buy it at
Amazon.com
Amazon.co.uk

Getting his monthly anthropological fix

In some ways the Grosvenors, old-money Yankees, were other-worldly. Mr Poole recalls, for instance, the reaction of Melville Grosvenor, Bell's grandson, when he sifted through black-and-white photographs of Hungarian refugees from Soviet repression dragging their few possessions through the railway station in Vienna in 1956. “Those poor people,” the editor said tearfully. “All they have is in those little bags—their clothes, their papers, their stocks and bonds.”

Yet this very innocence helped the magazine, at its peak, to attract nearly 11m subscribers. Readers wanted to get away for a while from the often sordid, often brutal reality of the 20th century. Between its lurid yellow covers, *National Geographic* was a refuge, one protected by its “three-monkey rule”: the Grosvenors expected their writers and photographers to see, hear and speak no evil.

A determination to stress the positive had one exceedingly odd consequence. For much of the last century the Soviet Union was all but ignored. The Grosvenors could not see any way of reporting honestly on the country without mentioning its horrors; so they declared, in effect, that it simply did not exist.

Gradually but inexorably, everything changed—though not, in Mr Poole's opinion, necessarily for the better—when the last of the Grosvenor editors relinquished the chair to become president of the society in 1980. Nepotism, Mr Poole concedes, is a tradition now rather frowned upon in the West. Nonetheless, it has virtues: “It allows for families to test future leaders under close observation, provides for continuity of values and usually assures orderly transitions.”

Nepotism can also cut corporate bureaucracy. Where once only the Grosvenors really mattered, there is now a sprawling enterprise with, by the author's count, six chairmen, 22 presidents, six executive vice-presidents, 25 senior vice-presidents and 50 vice-presidents. The old culture, driven and directed by editorial talent, has given way to a new culture dominated by marketing experts, lawyers, advertising executives and accountants, all of them paid “very well”. Despite them, its surplus (as a charity, the society has nothing so grubby as profits) has declined. It is a message that the Murdochs, the Sulzbergers and other dynastic media families will enjoy.

Explorers House: National Geographic and the World it Made.
By Robert M. Poole.
The Penguin Press; 357 pages; $25.95

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

New fiction

South African badlands

Oct 14th 2004
From The Economist print edition

TWO of the most interesting novels to have emerged from South Africa recently are both set in mythical badlands close to the nation's borders, where life is a prison, where new beginnings are always false dawns, and where every man and woman is destined to meet a bad end.

“A Blade of Grass” is a first novel by a South African artist who has emigrated to Canada. It appeared on this year's Man Booker prize longlist. Marit Laurens, a white farmer's wife, tries to impose some normality on her life after her young husband is blown up by a road mine. Torn between her harsh Afrikaner neighbours and the implacable black workers living on her farm, Marit is by turns frightened and confused. She turns to the only person who can offer her friendship, her black maid, Tembi.

Similar themes have been picked over before, most memorably perhaps in “The Shadow”, the first and only novel published by T.J. Lindsay, then a young advertising copywriter. But in the course of exploring how every human encounter in Africa is still governed in its first instance by the colour of a person's skin, Lewis Desoto, nearly 20 years after Mr Lindsay, does something few African writers have dared try: stitch black people into white skins, and vice versa. Marit is forced by her African foreman to do Tembi's job in the kitchen, fetching beers and serving him tea, while Tembi floats around the farmhouse in Marit's favourite silk dress. The details are domestic, the transformation brutally effective.

Where Mr Desoto focuses on skin, Damon Galgut is more interested in identity. His fifth novel, “The Good Doctor”, was shortlisted last year for the Man Booker prize. In “The Quarry”, an earlier work which has just been published for the first time in Britain, a nameless man, travelling along a lonely stretch of road, commits a murder. The victim is a Christian minister on his way to taking up a post at a black church in a nearby town. The murderer, who is already being hunted by the police, decides to steal the dead man's identity, only to find that one of his first duties as the new dominee is to bury a body that has just been discovered close to a disused quarry.

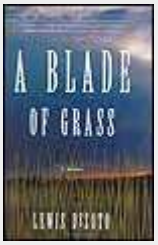
The tight plot is given added force by Mr Galgut's literary style, which marries a sharp ear for phrasing (“the dark clapped down like a hand”, “the doors of the locked church cracked down the middle and yawned”) with a taste for literary experimentation.

The quarry features in this novel in both senses of the word, as Mr Galgut's characters try on every page to escape their destiny—on foot, in trucks or by train. As the author puts it close to the end of the book: “It felt as if his whole life had been extended in motion, had consisted of no substance but flight.” As the chase goes on, Mr Galgut's sentences get lighter and lighter, and his chapters ever more fleeting, some as short as half a page. With admirable skill, the author runs as if towards a vanishing point.

Though not well known, Mr Galgut, at 41, has a loyal following in his own land and abroad. “The Quarry” proves that he has the talent to grow into one of South Africa's great literary voices, alongside its two Nobel laureates, Nadine Gordimer and J.M. Coetzee.

A Blade of Grass.
By Lewis Desoto.

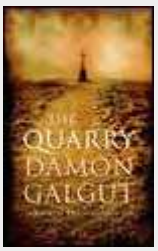
A Blade of Grass
By Lewis Desoto



Ecco Press; 400 pages; $13.95.
Maia Press; £8.99

Buy it at
Amazon.com
Amazon.co.uk

The Quarry
By Damon Galgut



Atlantic Books; 167 pages; £12.99. To be published in America by Grove Press in February 2005

Buy it at
Amazon.co.uk

Ecco Press; 400 pages; $13.95.
Maia Press; £8.99

The Quarry.
By Damon Galgut.
Atlantic Books; 167 pages; £12.99. To be published in America by Grove Press in February 2005

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

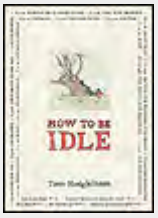
Idling

A call to inaction

Oct 14th 2004
From The Economist print edition

IF WRITING is hard work, writing about idleness is doubly so: when describing the pleasures of a cup of tea and then a nap, the temptation to turn the description into action is great. Yet Tom Hodgkinson has made a career out of it. He edits the *Idler*, a funny, slightly subversive magazine dedicated to the joys of sloth, published at the none-too-taxing rate of an issue every six months. Condensed from over ten years of writing about doing very little, his book is an attempt to set out a philosophy of indolence.

How to Be Idle
By Tom Hodgkinson



Hamish Hamilton; 288 pages; £12.99

Buy it at
Amazon.co.uk

Twenty-four loosely themed chapters, one for each hour of the idler's day, hand out advice on waking up (and how to avoid it), on skiving, and on the pleasures of tea and alcohol. Yet Mr Hodgkinson is no apologist for the merely lazy. He defends idleness as the key to genius. Descartes, he points out, was fond of sleeping in, and it did him no harm. It is easy, he writes, "to see how someone so inactive should conclude that the mind and body are separate entities. Laziness produced Cartesian duality."

A radicalism bubbles throughout the book. Light-hearted quotes from Oscar Wilde and G.K. Chesterton spice the polemics of Thomas Paine and the poetry of William Blake. The book's target is the puritanical work ethic and the rushed monotony suffered by so many in the corporate world. Mr Hodgkinson wants you to rediscover life at a slower pace: sleeping in, staring at the stars, and allowing yourself the sozzled pleasures of a three-hour lunch. He looks back to a pre-industrial world when men lived in tune with their surroundings and had time to think and dream about the big subjects in life. It is a gently English take on the myth of the noble savage.

Mirthless pedants may object to all this. Nobody would seriously argue that life really was better 300 years ago, when life expectancy was low and sleeping in meant going hungry. Yet such criticism would miss the point. Mr Hodgkinson never lets the tone stray too far into seriousness. The book might change your life, but it is more likely just to make you laugh. That, in itself, is a welcome relief from the drudgery of so much of modern life.

How to Be Idle.
By Tom Hodgkinson.
Hamish Hamilton; 288 pages; £12.99

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Obituary

Christopher Reeve

Oct 14th 2004
From The Economist print edition

Magnum Photos

Christopher Reeve, actor and campaigner, died on October 10th, aged 52

WHEN the first “Superman” film was made, back in 1978, the flying had to be done by means of wires suspended from cranes. If the wires showed through on the final print, an artist had to paint them out frame by frame. As the superhero “flew”, a small army of assistants stood by to check that his hair was blowing as it should. The hardest part, however, was getting the red cape to flap and float as if it was truly clearing the Chrysler building.

For Christopher Reeve, who had been picked from 200 hopefuls to play him, none of the artifice mattered. He had “just totally bought into” the business of derring-do. Months in the gym had put pounds on his skinny body. His muscles rippled under his tights. He could fly better than the stuntmen; indeed, he believed that he was flying, just as he believed the fearless hokum he had to speak while wafting Lois Lane to safety. The part did not need such efforts any more—late 20th-century Superman could be clumsy, chummy and self-deprecating, too—but Mr Reeve played him like a knight errant, and to the hilt. He later confessed that he was probably a danger to everyone when caped and in his flying harness, because of what he thought he could do.

Journalists in those days often asked him what heroism was. Not leaving his persona for a moment, he said: “Someone who commits a courageous action without considering the consequences.” As Superman, he knew all about that.

In later years, he professed to have changed his mind completely. Certainly his body had changed. A riding accident in 1995 had confined him to a wheelchair, paralysed from the neck down. He could move, with effort, the index finger of his left hand, breathed mostly through a ventilator, and needed as many people to support him standing as had once arranged Superman's cape. Heroism, he said now, was simply enduring, as he did every day.

He never meant that. Mr Reeve still believed, with every fibre of his body, in taking risks. Most especially, he wanted scientists to do so. His heroes were no longer characters who, like his former self, could dive, fly, fight and make the world turn backwards. They were men like V.R. Edgerton at UCLA, who severed the spinal cords of cats and put them on treadmills to see if they could imitate the action of stepping forward; or like Hongyun Huang in China, who injected cells from aborted human fetuses into the spinal cords of almost 400 paralysed patients, seeing if it would help them walk again.

Most American scientists viewed such experiments with distaste. They preferred to move slowly, through painstaking trials, and certainly to take no risks with human subjects. Their reputations were as precious to them as the grant money that came from a cautious government. Mr Reeve detested this attitude. He wanted to walk again. Doctors, scientists and government should be working night and day to make it possible. Enduring was for other people, the sort who were content to be in wheelchairs and make the best of it. He was not content. Though he sometimes called himself “President of the Disabled”, and was by far their most famous face, he was fighting less for them than for himself. He had never wanted to join their “club”. He clung fiercely to the notion of standing, pacing forward and being “normal” again. If some bold act might make that possible, then doctors should do it, and now.

Tears of frustration

Shortly after his accident, Mr Reeve got in contact with the American Paralysis Association; within a year he had turned it into his foundation, dispensing $13m in grants each year for spinal-cord work. He set up shop at the Reeve-Irvine Research Centre in the University of California, and made spinal-cord research a speciality there. In 1998 he began to press for a bigger budget for the National Institutes of Health, winning it a 15% increase in the next fiscal year. He campaigned tirelessly round the country for funding for stem-cell research—if not at federal level, then state by state—and got the issue, and his name, into the second of this year's presidential debates.

Meanwhile his own progress, though astonishing to doctors, remained stubbornly far from his own hopes. It was true that he could travel, write books, direct films and even star in one: a re-make of Alfred Hitchcock's “Rear Window” in which, for maximum effect, he insisted on cutting his breathing tube for a scene in which the hero began to choke to death. He was still a star, doing work he loved. But his body recovered with agonising slowness. By 2003, he could brace the biceps of his right arm and breathe for hours on his own. A year later, though, he had given up the bicycle and treadmill on which his legs had been tricked, with electric shocks, into a semblance of working. He admitted to starting each day by weeping in frustration.

There had been four “Superman” films. Mr Reeve had hoped to get away from him and make different films, or even to return to his first love, the stage, where he had known moderate success as a clean-cut leading man. Yet in 2001 he thought “Superman 5”, starring himself, would be “a wonderful idea”. The only problem was that he was a little old for the part, and would be older by the time he was able to leap tall buildings again. But, if he just kept pushing, the day would come.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Oct 14th 2004
From The Economist print edition

America's non-farm payrolls grew by only 96,000 in September, slower than expected. Jobs growth may have been depressed by the hurricanes which hit southern states. The unemployment rate held steady at 5.4% of the labour force.

In September, the jobless rate fell to 7.1% in **Canada** and was unchanged at 3.7% in **Switzerland**. **Britain's** unemployment rate also remained unchanged at 4.7% in the three months to August.

Euro-area output was much weaker than expected in August. **Germany's** industrial production fell by a bigger-than-expected 1%, although the 12-month growth rate rose to 3.7%. **France's** industrial output dropped by 1.9% in August, reducing annual growth to only 0.7%. However, the drop was largely due to the temporary closure of a car plant. **Italy's** production fell by 0.8% in the same month, leaving output 3.5% lower than a year ago.

Britain's inflation rate unexpectedly declined to 1.1% in September, from 1.3% in August, well below the Bank of England's 2% target. However, producer prices rose by 3.1% over the same period, the biggest increase in more than eight years, thanks largely to higher oil and metal prices.

Oil prices reached new highs this week. West Texas Intermediate rose above $54 a barrel, before falling back slightly.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Output, demand and jobs

Oct 14th 2004
From The Economist print edition

% change on year ago

	GDP latest	GDP qtr*	The Economist poll GDP forecasts 2004	The Economist poll GDP forecasts 2005	Industrial production latest	Retail sales (volume) latest	Unemployment % rate latest	Unemployment % rate year ago
Australia	+ 4.1 Q2	+ 2.5	+ 3.7	+ 3.3	+ 4.6 Q2	+ 7.9 Q2	5.6 Sep	5.9
Austria	+ 1.9 Q2	+ 3.6	+ 1.6	+ 2.1	+ 6.1 Jul	+ 5.8 Jun	4.5 Sep	4.5
Belgium	+ 2.7 Q2	+ 3.0	+ 2.4	+ 2.1	+ 1.5 Jul	+ 1.7 Jul	13.2 Sep†	13.2
Britain	+ 3.6 Q2	+ 3.6	+ 3.4	+ 2.7	– 0.1 Aug	+ 6.5 Aug	4.7 Aug††	5.0
Canada	+ 3.0 Q2	+ 4.3	+ 3.0	+ 3.4	+ 4.1 Jul	+ 3.1 Jun	7.1 Sep	7.9
Denmark	+ 2.6 Q2	+ 0.9	+ 2.2	+ 2.3	– 1.1 Aug	+ 4.5 Aug	6.3 Aug	6.1
France	+ 2.8 Q2	+ 2.8	+ 2.5	+ 2.3	+ 0.7 Aug	+ 1.0 Aug	9.9 Aug	9.8
Germany	+ 2.0 Q2	+ 1.9	+ 1.5	+ 1.7	+ 3.7 Aug	– 1.4 Aug	10.7 Sep§	10.5
Italy	+ 1.2 Q2	+ 1.1	+ 1.2	+ 1.6	– 3.5 Aug	– 2.3 Jul	8.5 Apr	8.7
Japan	+ 4.2 Q2	+ 1.3	+ 4.3	+ 2.2	+ 9.7 Aug	– 1.6 Aug	4.8 Aug	5.1
Netherlands	+ 1.3 Q2	– 0.4	+ 1.2	+ 1.6	– 0.1 Aug	– 0.7 Jun‡	6.1 Sep**	5.4
Spain	+ 2.6 Q2	+ 2.0	+ 2.6	+ 2.6	+ 5.5 Aug	– 1.6 Aug	11.0 Aug	11.2
Sweden	+ 3.6 Q2	+ 4.0	+ 3.3	+ 2.8	+ 3.9 Aug	+ 6.4 Aug	5.5 Aug†	5.4
Switzerland	+ 2.0 Q2	+ 1.6	+ 1.9	+ 2.0	+ 4.3 Q2	+ 3.1 Aug	3.7 Sep†	3.7
United States	+ 4.8 Q2	+ 3.3	+ 4.3	+ 3.4	+ 5.2 Aug	+ 4.1 Aug	5.4 Sep	6.1
Euro area	+ 2.0 Q2	+ 2.1	+ 1.9	+ 1.9	+ 2.4 Jul	– 0.4 Aug	9.0 Aug	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 2.7 Q2	+ 2.9	na	na	+ 7.2 Aug	+ 5.1 Jul	8.0 Aug†	7.7
Greece	+ 3.9 Q2	– 0.6	na	na	– 0.5 Aug	+ 6.6 Jul	na	na
Iceland	+ 6.2 Q2	na	na	na	na	na	3.0 Jul†	3.0
Ireland	+ 4.1 Q2	na	na	na	+ 6.4 Jul	+ 1.2 Jul	4.5 Sep	4.6
Luxembourg	+ 2.12003	na	na	na	– 1.2 Dec	– 1.1 May	4.1 Aug	3.6
New Zealand	+ 6.0 Q2	+ 4.6	na	na	+ 5.5 Q2	+ 6.8 Q2	4.0 Q2	4.7
Norway	+ 4.1 Q2	+ 5.0	na	na	– 6.5 Aug	+ 3.6 Aug	4.6 Q2	4.7
Portugal	+ 1.5 Q2	+ 4.7	na	na	– 3.9 Aug	+ 5.4 Aug	6.3 Q2†	6.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Jun-Aug; claimant count rate 2.7% in Sep. §EU harmonised rate 9.9% in Aug. **Jul-Sep.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Prices and wages

Oct 14th 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.5	Q2	+ 2.7	+ 2.4	+ 2.7	+ 2.8	Q2	+ 0.2	+ 2.9	Q2	+ 5.5
Austria	+ 2.4	Aug	+ 1.2	+ 1.7	+ 1.6	+ 6.0	Sep	+ 1.3	+ 1.9	Aug	+ 2.3
Belgium	+ 2.0	Sep	+ 1.8	+ 1.9	+ 1.7	+ 5.8	Aug	– 1.4	+ 2.2	Jul	+ 1.9
Britain	+ 1.1	Sep*	+ 1.4	+ 1.4	+ 1.8	+ 3.1	Sep	+ 1.4	+ 3.9	Aug†	+ 3.4
Canada	+ 1.9	Aug	+ 2.0	+ 2.0	+ 2.2	+ 4.9	Aug	– 1.9	+ 1.5	Jul	+ 5.1
Denmark	+ 1.1	Sep	+ 1.9	+ 1.2	+ 1.8	+ 3.1	Aug	– 0.3	+ 3.1	Q2	+ 3.8
France	+ 2.2	Sep	+ 2.1	+ 2.2	+ 1.6	+ 2.8	Aug	+ 0.5	+ 2.8	Q2	+ 2.7
Germany	+ 1.8	Sep	+ 1.1	+ 1.7	+ 1.3	+ 3.4	Sep	+ 0.5	+ 0.5	Jul	+ 1.4
Italy	+ 2.1	Sep	+ 2.8	+ 2.3	+ 2.1	+ 3.5	Aug	+ 1.4	+ 2.6	Aug	+ 2.6
Japan	– 0.2	Aug	– 0.3	– 0.1	+ 0.1	+ 1.8	Sep	– 0.6	+ 1.3	Aug	+ 0.7
Netherlands	+ 1.0	Sep	+ 2.0	+ 1.4	+ 1.2	+ 5.3	Aug	+ 0.6	+ 1.1	Sep	+ 2.6
Spain	+ 3.2	Sep	+ 2.9	+ 2.9	+ 2.7	+ 4.4	Aug	+ 1.1	+ 3.1	Q2	+ 4.2
Sweden	+ 0.6	Sep	+ 1.7	+ 0.8	+ 1.5	+ 2.0	Aug	– 1.7	+ 2.4	Jul	+ 3.6
Switzerland	+ 0.9	Sep	+ 0.5	+ 0.8	+ 1.1	+ 1.5	Aug	– 0.3	+ 1.4	2003	+ 1.8
United States	+ 2.7	Aug	+ 2.2	+ 2.6	+ 2.2	+ 3.4	Aug	+ 3.5	+ 2.4	Sep	+ 2.4
Euro area	+ 2.2	Sep	+ 2.2	+ 2.1	+ 1.7	+ 3.1	Aug	+ 1.4	+ 2.2	Q2	+ 3.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.4	Sep	+ 0.7	na	na	+ 1.8	Aug	+ 0.3	+ 3.5	Q2	+ 4.4
Greece	+ 2.8	Sep	+ 3.3	na	na	+ 2.1	Aug	+ 2.2	na		na
Iceland	+ 3.7	Oct	+ 2.2	na	na	+ 7.2	Sep	+ 3.6	+ 5.2	Aug	+ 5.7
Ireland	+ 2.6	Aug	+ 3.2	na	na	– 0.4	Aug	– 7.8	+ 3.8	Q2	+ 8.0
Luxembourg	+ 2.0	Sep	+ 2.1	na	na	+ 9.6	Jul	+ 0.7	– 0.4	Dec	+ 0.7
New Zealand	+ 2.4	Q2	+ 1.5	na	na	+ 1.5	Q2	– 1.9	+ 2.3	Q2	+ 2.3
Norway	+ 1.1	Sep	+ 2.1	na	na	+20.3	Sep	– 0.5	+ 4.5	Q2	+ 5.4
Portugal	+ 2.3	Aug	+ 2.8	na	na	+ 4.1	Aug	+ 0.1	– 0.2	Aug	– 1.4

*New series. RPI inflation rate in September: 3.1%. †Jun-Aug.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Portfolio poll

Oct 14th 2004
From The Economist print edition

Portfolio poll

3rd quarter 2004

▼▲A change of 5% points or more on previous quarter ▼▲A change of less than 5% points on previous quarter

	Holdings by instrument, %			Equity holdings by area, %						
	Equities	Bonds	Cash	United States	Other Americas	Britain	Euro area	Other Europe	Japan	Other Asia
Credit Suisse PB	36 ▲	31 ▼	33† ▲	67 ▲	0	0	15 ▼	0 ▼	7 ▼	11 ▼
Henderson	60	35 ▲	5 ▼	50	3	7	18	3	15	4
Julius Baer PB	42	37	21‡	43	2	3	30	3	12	7
IPM-First Quadrant	53 ▲	47 ▼	0 ▼	54 ▲	3 ▼	5 ▲	13 ▼	5 ▼	17 ▲	3 ▲
Lehman Brothers	70	30	0	43 ▼	0	5	32 ▲	0 ▼	8 ▼	11 ▲
Robeco Group	55 ▲	45	0 ▼	51 ▼	3 ▲	11 ▼	14 ▲	5 ▼	12 ▼	5 ▲
Average	53 ▲	38 ▼	10 ▼	51 ▲	2 ▼	5 ▲	20 ▲	3 ▼	12 ▼	7 ▲
Neutral*				55	3 ▲	11 ▲	14 ▲	4 ▼	10 ▼	3 ▲

Bond holdings by currency, %

Dollar	Yen	Sterling	Euro area	Others
88 ▼	0	0	12 ▲	0
15	30	5	50	0
88	0	0	7	5
32 ▼	32 ▼	0 ▲	31 ▲	5 ▲
37 ▲	13 ▼	4	36 ▲	11 ▼
40 ▼	19 ▲	7 ▼	33 ▲	1 ▼
50 ▼	16 ▲	3 ▼	28 ▲	4 ▲
21 ▲	29 ▼	5 ▲	40 ▼	5 ▼

*Morgan Stanley Capital International (developed) world equity index; Citigroup world government-bond index
†Of which 18% invested in alternative investments
‡Of which 11% invested in alternative investments

Totals may not add up to 100% due to rounding

According to our latest portfolio poll, our money managers made few big changes to their positions in the third quarter. Several boosted their equity holdings, but only IPM-First Quadrant did so by more than five percentage-points. Allocations to cash and bonds fell on average, although Henderson and Credit Suisse were the exceptions by moving, respectively, into bonds and cash. Our managers became more bullish on euro-denominated bonds, while IPM and Robeco Group reduced their allocations to dollar-denominated bonds. Views on equities were mixed. Credit Suisse alone increased its already large allocation to American equities by more than five percentage-points, while reducing its exposure to the euro area. Lehman Brothers, by contrast, sought more exposure to euro-area shares while cutting its allocation to Japanese equities more sharply than the other poll participants.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Money and interest rates

Oct 14th 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Oct 13th 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 5.6	+10.0	Aug	5.41	5.00	5.08	5.44	5.66	6.19
Britain	+ 5.1	+ 9.7	Aug	4.84	3.63	4.56	4.75	4.90	5.40
Canada	+10.5	+ 9.1	Aug	2.52	2.65	3.22	4.57	4.96	6.13
Denmark	+ 9.5	+11.1	Aug	2.25	2.19	2.66	3.96	4.46	5.33
Japan	+ 4.1	+ 2.1	Sep	0.03	0.02	0.13	1.48	1.42	1.54
Sweden	+ 1.1	+ 1.5	Aug	2.04	2.71	2.73	4.19	4.85	2.82
Switzerland	+ 0.6	+ 2.0	Aug	0.72	0.25	0.99	2.49	2.70	2.31
United States	+ 4.7	+ 4.4	Aug	2.00	1.06	2.51	4.08	4.40	5.66
Euro area†	+ 9.3	+ 5.5	Aug	2.15	2.14	2.47	3.87	4.28	3.72

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.85%, Japan No. 264 1.49%. Central bank rates: US fed funds 1.75%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Economist commodity price index

Oct 14th 2004
From The Economist print edition

1995=100

	Oct 5th	Oct 12th*	% change on one month	% change on one year
Dollar index				
All items	87.8	87.8	nil	+ 5.0
Food	78.9	78.9	– 2.6	– 4.8
Industrials				
All	99.8	100.0	+ 3.0	+18.2
Nfa†	83.2	82.0	– 9.6	– 6.8
Metals	113.8	115.1	+12.5	+41.0
Sterling index				
All items	77.7	77.5	+ 0.8	– 2.0
Euro index				
All items	93.8	93.9	– 0.2	– 0.2
Yen index				
All items	103.8	102.6	+ 0.2	+ 5.4
Gold				
$ per oz	415.98	414.00	+ 1.9	+10.1
West Texas Intermediate				
$ per barrel	51.06	52.46	+18.2	+65.3

* Provisional. † Non-food agriculturals.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Stockmarkets

Oct 14th 2004
From The Economist print edition

Market indices

	Oct 13th	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,734.0	3,734.0	3,274.9	+ 0.7	nil	+12.9	+ 8.5
Austria (ATX)	2,089.2	2,119.0	1,568.9	– 1.4	– 1.4	+35.2	+31.5
Belgium (Bel 20)	2,752.5	2,775.2	2,244.2	– 0.8	–25.2	+22.7	+19.3
Britain (FTSE 100)	4,634.8	4,707.1	4,287.0	– 1.5	–33.1	+ 3.5	+ 3.4
Canada (Toronto Composite)	8,729.6	8,898.8	8,123.5	– 1.6	–23.3	+ 6.2	+ 8.5
Denmark (KBX)	250.3	253.0	219.0	– 0.7	–17.0	+17.2	+14.1
France (SBF 250)	2,528.8	2,594.4	2,386.1	– 1.6	–42.4	+ 4.9	+ 2.0
(CAC 40)	3,694.3	3,811.4	3,465.3	– 1.9	–46.6	+ 3.8	+ 1.0
Germany (DAX)	3,976.0	4,151.8	3,647.0	– 1.8	–50.7	+ 0.3	– 2.5
Italy (BCI)	1,349.7	1,356.4	1,239.5	– 0.1	–38.2	+ 7.4	+ 4.5
Japan (Nikkei 225)	11,196.0	12,163.9	10,365.4	– 1.7	–71.2	+ 4.9	+ 2.3
(Topix)	1,123.5	1,217.9	1,022.6	– 2.1	–61.1	+ 7.6	+ 5.0
Netherlands (AEX)	331.5	364.8	310.7	– 1.6	–52.7	– 1.8	– 4.5
Spain (Madrid SE)	877.4	881.7	804.4	– 0.2	–23.5	+ 8.6	+ 5.6
Sweden (Affarsvarlden Gen)	212.3	218.1	188.5	nil	–47.0	+12.7	+ 9.7
Switzerland (Swiss Market)	5,462.8	5,934.4	5,309.8	– 2.3	–35.1	– 0.5	– 2.3
United States (DJIA)	10,002.3	10,737.7	9,814.6	– 2.3	–14.7	– 4.3	– 4.3
(S&P 500)	1,113.7	1,157.8	1,063.2	– 2.5	–27.1	+ 0.2	+ 0.2
(NASDAQ Comp)	1,920.5	2,153.8	1,752.5	– 2.6	–62.0	– 4.1	– 4.1
Europe (FTSE Eurotop 300)*	1,004.0	1,026.2	940.9	– 1.1	–41.1	+ 4.8	+ 1.9
Euro area (FTSE Ebloc 100)*	850.9	888.3	787.2	– 1.4	–45.1	+ 2.3	– 0.5
World (MSCI)†	1,051.7	1,085.8	997.0	– 1.5	–27.4	+ 1.5	+ 1.5
World bond market (Citigroup)‡	613.0	619.5	575.1	+ 0.4	– 1.1	+ 1.5	+ 1.5

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Trade, exchange rates and budgets

Oct 14th 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current-account balance $bn latest 12 mths	Current-account balance The Economist poll % of GDP, forecast 2004	Current-account balance The Economist poll % of GDP, forecast 2005	Exchange rate trade-weighted† 1990=100 Oct 13th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Oct 13th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2004‡
Australia	− 17.0 Aug	− 34.2 Q2	− 5.8	− 5.0	85.3	83.8	1.38	1.45	2.47	1.70	1.26	+ 0.5
Austria	− 0.5 Jul	− 2.0 Jul	− 0.3	− 0.4	103.0§	102.8	0.82	0.86	1.46	–	0.74	− 1.3
Belgium	+ 20.3 Jul	+ 13.0 Jun	+ 3.2	+ 3.2	103.1§	102.8	0.82	0.86	1.46	–	0.74	− 0.2
Britain	−100.8 Aug	− 41.7 Q2	− 2.4	− 2.6	102.6	99.7	0.56	0.60	–	0.69	0.51	− 2.9
Canada	+ 49.3 Jul	+ 23.8 Q2	+ 2.8	+ 2.4	91.2	87.5	1.27	1.33	2.26	1.55	1.15	+ 1.2
Denmark	+ 10.1 Aug	+ 6.8 Aug	+ 2.9	+ 2.6	106.5	106.1	6.06	6.38	10.8	7.44	5.52	+ 0.9
France	− 0.9 Aug††	− 0.7 Jul	+ 0.3	+ 0.3	106.5§	106.1	0.82	0.86	1.46	–	0.74	− 3.8
Germany	+188.1 Aug	+ 92.5 Aug	+ 3.1	+ 2.9	104.3§	103.7	0.82	0.86	1.46	–	0.74	− 3.7
Italy	+ 3.3 Jul	− 14.0 Jul	− 0.9	− 1.1	76.0§	75.6	0.82	0.86	1.46	–	0.74	− 3.1
Japan	+132.7 Aug	+167.0 Aug	+ 3.5	+ 3.5	133.7	137.2	110	110	196	135	–	− 7.1
Netherlands	+ 34.2 Aug	+ 20.7 Q2	+ 2.9	+ 3.0	102.5§	102.2	0.82	0.86	1.46	–	0.74	− 3.1
Spain	− 64.0 Jul	− 33.4 Jun	− 3.1	− 3.1	77.1§	76.9	0.82	0.86	1.46	–	0.74	+ 0.3
Sweden	+ 22.9 Aug	+ 23.4 Q2	+ 6.6	+ 6.1	82.0	82.4	7.39	7.70	13.2	9.06	6.73	+ 0.2
Switzerland	+ 8.2 Aug	+ 45.0 Q2	+11.3	+10.8	112.4	111.4	1.26	1.33	2.25	1.55	1.15	− 1.6
United States	−598.3 Jul	−571.9 Q2	− 5.5	− 5.3	95.7	99.3	–	–	1.79	1.23	0.91	− 4.7
Euro area	+111.8 Jul	+ 61.5 Jul	+ 0.6	+ 0.6	91.1	89.6	0.82	0.86	1.46	–	0.74	− 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 14.8 Jul	+ 11.2 Jul	na	na	82.1§	81.8	0.81	0.86	1.45	–	0.74	+ 1.6
Greece	− 28.6 Jul	− 11.1 Jul	na	na	59.6§	59.4	0.81	0.86	1.45	–	0.74	− 3.2
Iceland	− 0.5 Aug	− 0.6 Q2	na	na	95.7**	97.2	71.0	76.6	127	87.1	64.6	+ 0.2
Ireland	+ 42.4 Jul	− 1.7 Q2	na	na	94.2§	94.3	0.81	0.86	1.45	–	0.74	− 0.5
Luxembourg	− 4.3 Jul	+ 2.1 Q2	na	na	103.1§	102.8	0.81	0.86	1.45	–	0.74	− 1.8
New Zealand	− 2.4 Aug	− 3.9 Q2	na	na	107.3	97.2	1.48	1.68	2.65	1.82	1.35	+ 2.9
Norway	+ 30.2 Aug	+ 31.2 Jul	na	na	98.2	96.7	6.68	7.10	11.9	8.19	6.08	+ 10.4
Portugal	− 16.6 Jul	− 10.0 Jul	na	na	93.4**	93.8	0.81	0.86	1.45	–	0.74	− 3.8

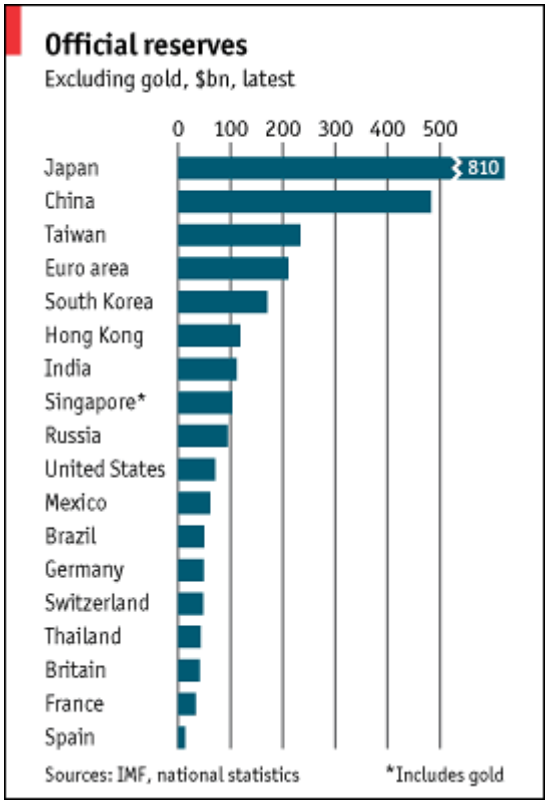
*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, August average. ‡OECD forecast. ††New series. **IMF, June average.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

About sponsorship

Official reserves

Oct 14th 2004
From The Economist print edition



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Oct 14th 2004
From The Economist print edition

Industrial output in **South Korea** rose by 10.6% in the year to August. In **India**, production rose by 7.9% over the same period.

In Latin America, factories got busier. Industrial production in **Brazil** increased by 13.1% in the year to August. And in **Mexico**, output picked up to 5.2% over the same period.

Consumer-price inflation in **Brazil** slackened to 6.7% in the year to September.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Growth competitiveness

Oct 14th 2004
From The Economist print edition

Finland again tops the World Economic Forum's league table of global competitiveness, followed by the United States. Of the ten highest-ranked countries, five are Nordic. Despite high taxes, these countries receive high marks for the quality of their public services and macroeconomic policy, including budget surpluses, areas in which America mostly scores lower. Thanks partly to its economic recovery, Japan moved up to ninth place from 21st in 2001.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economy

Oct 14th 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.6	Q2	+15.9	Aug	+ 5.3	Aug	+20.9	Sep	+45.9	2003	483.0	Jul
Hong Kong	+12.1	Q2	+ 1.1	Q2	+ 0.8	Aug	−13.6	Aug	+13.6	Q2	118.4	Sep
India	+ 7.4	Q2	+ 7.9	Aug	+ 4.6	Aug	−18.5	Aug	+11.0	Q2	113.3	Sep
Indonesia	+ 4.3	Q2	− 9.6	Jul	+ 6.3	Sep	+24.3	Aug	+ 3.9	Q2	33.6	Aug
Malaysia	+ 8.0	Q2	+10.6	Aug	+ 1.6	Sep	+20.2	Aug	+13.6	Q2	56.9	Sep
Philippines	+ 6.2	Q2	− 0.4	Jul	+ 6.9	Sep	− 1.6	Jul	+ 4.5	Jun	12.5	Sep
Singapore	+ 7.7	Q3	+ 5.3	Aug	+ 1.6	Aug	+16.0	Aug	+28.4	Q2	102.8	Sep
South Korea	+ 5.5	Q2	+10.6	Aug	+ 3.9	Sep	+29.2	Sep	+27.3	Aug	170.4	Aug
Taiwan	+ 7.7	Q2	+ 8.8	Aug	+ 2.8	Sep	+10.8	Sep	+25.8	Q2	233.0	Sep
Thailand	+ 6.3	Q2	+ 6.1	Aug	+ 3.6	Sep	+ 1.3	Aug	+ 6.7	Aug	42.8	Aug
Argentina	+ 7.0	Q2	+ 8.4	Aug	+ 5.8	Sep	+12.6	Aug	+ 6.1	Q1	18.2	Sep
Brazil	+ 5.7	Q2	+13.1	Aug	+ 6.7	Sep	+32.2	Sep	+ 9.7	Aug	49.6	Aug
Chile	+ 5.1	Q2	+ 9.0	Aug	+ 2.2	Sep	+ 7.4	Aug	+ 1.2	Q2	15.8	Sep
Colombia	+ 4.3	Q2	+ 4.9	Jul	+ 6.0	Sep	+ 0.2	Jul	− 1.6	Q2	12.0	Sep
Mexico	+ 3.9	Q2	+ 5.2	Aug	+ 5.1	Sep	− 5.9	Aug	− 6.7	Q2	61.0	Aug
Peru	+ 3.8	Jul	+ 8.4	Jul	+ 4.0	Sep	+ 1.9	Aug	− 0.7	Q2	11.2	Sep
Venezuela	+13.6	Q2	+27.6	Jul	+20.8	Sep	+20.3	Q2	+14.0	Q2	18.7	Jul
Egypt	+ 4.3	2004†	+ 2.6	2003†	+16.5	May‡	− 7.5	Q2	+ 3.7	Q2	13.6	Jun
Israel	+ 3.0	Q2	+ 1.9	Jul	+ 0.5	Aug	− 6.2	Aug	+ 0.1	Q2	26.1	Sep
South Africa	+ 2.5	Q2	+ 6.8	Aug	+ 1.0	Aug	− 0.9	Aug	− 3.5	Q2	10.7	Sep
Turkey	+13.4	Q2	+ 8.8	Aug	+ 9.0	Sep	−31.2	Aug	−12.4	Aug	33.9	Aug
Czech Republic	+ 4.1	Q2	+ 8.7	Aug	+ 3.0	Sep	− 1.9	Aug	− 6.2	Q2	26.8	Sep
Hungary	+ 4.0	Q2	+ 3.6	Aug	+ 6.6	Sep	− 3.0	Q2	− 8.4	Q2	12.8	Sep
Poland	+ 6.1	Q2	+13.5	Aug	+ 4.6	Aug	− 5.3	Jul	− 4.0	Jul	35.3	Sep
Russia	+ 7.4	Q2	+ 6.8	Aug	+11.5	Sep	+71.8	Aug	+38.4	Q2	94.3	Sep
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 5.9	Q2	+ 6.0	Aug	+ 3.9	Sep	− 2.4	Jul	− 1.5	Q2	1.4	Sep
Latvia	+ 7.7	Q2	+ 6.4	Aug	+ 7.7	Sep	− 2.5	Jul	− 1.4	Jul	1.6	Aug
Lithuania	+ 6.9	Q2	na		+ 3.2	Sep	− 3.2	Aug	− 1.8	Q2	3.4	Aug
Slovakia	+ 5.4	Q2	+ 5.4	Aug	+ 6.6	Sep	− 1.1	Aug	− 0.7	Jul	12.7	Aug
Slovenia	+ 4.6	Q2	+11.5	Aug	+ 3.3	Sep	− 0.9	Aug	− 0.1	Jul	7.7	Jul
Pakistan	+ 6.4	2004†	+24.8	May	+ 9.0	Sep	− 3.9	Sep	+ 1.8	Q2	10.6	Aug
Saudi Arabia	+ 7.2	2003	na		+ 0.2	Jul	+61.2	2003	+29.7	2003	22.2	Aug

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series, % change Jan-May annualised.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Financial markets

Oct 14th 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Oct 13th		Dec 31st 2003	
	Oct 13th	year ago	Oct 13th	% a year		one week	in local currency	in $ terms
China	8.28	8.28	14.8	3.20	1,454.9	– 0.7	– 7.3	– 7.3
Hong Kong	7.79	7.74	13.9	1.09	13,171.6	– 0.8	+ 4.7	+ 4.4
India	45.8	45.7	81.9	5.02	5,676.7	– 0.6	– 2.8	– 3.1
Indonesia	9,140	8,425	16,339	7.51	863.2	+ 0.8	+ 24.8	+ 15.0
Malaysia	3.80	3.80	6.79	2.87	853.3	– 1.0	+ 7.5	+ 7.5
Philippines	56.4	54.6	100.8	7.63	1,790.7	– 2.8	+ 24.2	+ 22.2
Singapore	1.69	1.74	3.02	1.38	1,971.2	– 2.2	+ 11.7	+ 12.3
South Korea	1,149	1,170	2,054	3.53	856.2	– 3.5	+ 5.6	+ 9.5
Taiwan	33.9	33.8	60.6	1.25	5,963.1	– 1.6	+ 1.2	+ 1.4
Thailand	41.4	39.8	74.1	1.85	661.3	– 1.1	– 14.4	– 18.1
Argentina	2.98	2.84	5.33	5.63	1,165.7	+ 3.3	+ 8.7	+ 7.0
Brazil	2.83	2.83	5.06	16.24	23,289.0	– 3.1	+ 4.7	+ 6.8
Chile	603	649	1,078	2.04	8,502.0	– 2.3	+ 15.9	+ 13.9
Colombia	2,562	2,877	4,580	7.61	3,706.6	+ 2.8	+ 58.8	+ 72.3
Mexico	11.3	11.2	20.2	8.03	10,942.4	– 1.3	+ 24.4	+ 23.7
Peru	3.31	3.48	5.92	2.77	3,418.2	+ 1.8	+ 40.4	+ 46.9
Venezuela	2,486§	1,598	4,443	11.76	30,488.1	– 0.4	+ 37.3	+ 57.5
Egypt	6.24	6.16	11.15	10.92	20,155.9	– 0.3	+ 73.2	+ 71.1
Israel	4.47	4.42	7.99	1.00	552.2	– 3.1	+ 3.3	+ 1.6
South Africa	6.62	7.00	11.8	7.60	11,796.9	– 1.1	+ 13.6	+ 14.5
Turkey	1,491,000	1,409,000	2,665,312	23.87	22,630.0	+ 1.5	+ 21.5	+ 14.5
Czech Republic	25.7	27.5	45.9	2.66	900.5	+ 2.5	+ 36.6	+ 36.7
Hungary	202	220	360	10.57	12,868.9	+ 0.5	+ 37.2	+ 41.2
Poland	3.50	3.90	6.26	6.90	24,949.1	– 3.2	+ 19.8	+ 28.1
Russia	29.1	30.1	52.1	13.00	663.5‡	– 2.3	+ 16.5	+ 17.0
EMF (MSCI)*	1.00	1.00	1.79	na	467.6	– 2.7	+ 5.6	+ 5.6
EMBI+†	1.00	1.00	1.79	na	318.3	+ 1.5	+ 8.0	+ 8.0

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.